S. HRG. 101-486

MODIFICATION OF THE McCARRAN-FERGUSON ACT

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

S. 719

A BILL TO AMEND THE McCARRAN-FERGUSON ACT TO LIMIT THE FEDERAL ANTITRUST EXEMPTION OF THE BUSINESS OF INSURANCE, TO REAFFIRM THE CONTINUED STATE REGULATION OF THE BUSINESS OF INSURANCE, AND FOR OTHER PURPOSES

APRIL 18, 1989

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S. 719—MODIFICATION OF THE McCARRAN-FERGUSON ACT

TUESDAY, APRIL 18, 1989

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 9:37 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Howard Metzenbaum presiding.

Also present: Senators Thurmond, DeConcini, Heflin, Simon, Kohl, Hatch, Simpson, Grassley, and Specter.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator METZENBAUM. The committee will come to order.

This morning, we will hear testimony regarding S. 719, a bill to modify the antitrust exemption for insurance contained in the McCarran-Ferguson Act. Two weeks ago, I introduced S. 719, a bill to make the antitrust laws apply to the insurance industry just as they apply to other industries.

I am pleased to be joined in this effort by three cosponsors who are also members of the Judiciary Committee—Senators Simon, Biden, and Kennedy. We have room left for some additional cosponsors, I just thought I ought to point out.

Senator THURMOND. You have got too many now. [Laughter.]

Senator METZENBAUM. As many of you are aware, this is not the first bill I have introduced to modify McCarran-Ferguson. In the past, the industry has fended off attempts to change the status quo, blaming the insurance crisis on everything but its continued protection from the antitrust laws.

But I say to the insurance industry, the winds of change are blowing. The American public does not understand why a $500 billion industry, one of the largest and most powerful in the country, is exempt from the antitrust laws.

Just look at the groups that favor modifying McCarran-Ferguson—consumers, small business, State attorneys general, labor, senior citizens, women, banks, and medical associations—and the ranks of those in support of free competition for the insurance industry are growing.

I am most pleased that the American Bar Association recently endorsed modification of the antitrust exemption. I am particularly pleased to have the ABA join us on this issue because, as we all know, many members of the bar have insurance industry clients.

In fact, modification of the insurance exemption has a history of bipartisan support. Studies conducted under both President Ford and President Carter concluded that repeal of McCarran-Ferguson is in the public interest.

This committee heard testimony last Congress from members of the Reagan administration in support of modifying McCarran-Ferguson. I hope that members of the Bush administration will follow previous Republican administrations and support this type of reform.

In other words, the only consistent opponent to this type of legislation has been the insurance industry itself. The industry always makes two arguments against repeal, that legislation like S. 719 will eliminate State regulation, and that it will prevent useful joint activities such as sharing loss information.

I have no doubt that we will hear those same arguments again this morning, but as I have said over and over and over and over again, this legislation specifically retains State regulation and it provides continued immunity for joint collection of loss information and similar joint activities that benefit consumers.

And let me say this: The time has come to act on this issue because consumers won't wait. Last year, the attorneys general of 19 States filed a massive antitrust suit against some of the largest insurance companies.

In November, the people of California passed a referendum to roll back insurance rates across the board. Similar legislation is pending in several States.

The insurance industry must recognize that there is a sense of momentum out there that they have some special obligation to the public, and that special obligation doesn't include an exemption from the antitrust laws of this country.

These actions across the country make plain that consumers won't be patient any longer. There are issues of affordability and availability that need to be addressed. I believe that removing the antitrust exemption is one way to let the market, not the insurance companies, determine how much insurance should be sold and at what price.

It is time to talk seriously about modifying McCarran-Ferguson. Sometimes in the legislative process, the opportunity presents itself for people on both sides of an issue to engage in reasonable debate and compromise. But sometimes the forces opposed to change do not want to talk.

I have said repeatedly that I am willing to work with the industry to modify McCarran-Ferguson, and that offer stands; my door is open to discuss the issues. But let me say this: There are those who want much more radical change. California is just an example.

Some people would preempt all State regulation. That is not my proposal. I want to keep State regulation, but I also want change. The antitrust laws should apply to the insurance industry as they apply to all other industries.

I repeat again, my door is open. I am prepared to negotiate. I am prepared to talk. I am prepared to work out a reasonable bill.

I welcome the comments of our witnesses today and thank you for appearing before the committee. I am particularly pleased that

Senators Thurmond, Hatch, and Grassley are with us, as well as Senator Kohl.

Senator Thurmond, do you have an opening statement?

OPENING STATEMENT OF SENATOR STROM THURMOND

Senator THURMOND. Thank you, Mr. Chairman.

The hearing today is the first hearing we have held in this Congress on legislation that has been proposed by Senator Metzenbaum and others to repeal the McCarran-Ferguson antitrust exemption for the business of insurance.

This issue is not new to this committee. In fact, legislation very similar to S. 719 was introduced in the last Congress and was the subject of several hearings at that time.

McCarran-Ferguson provides an antitrust exemption for the business of insurance so long as there is State regulation. The exemption does not apply, however, to acts of boycott, coercion or intimidation.

McCarran-Ferguson was enacted in response to the Supreme Court's 1944 decision in *United States* v. *South-Eastern Underwriters Association*. That decision held that the business of insurance was within the regulatory power of Congress pursuant to the Commerce Clause.

Congress enacted McCarran-Ferguson in 1945 because the Supreme Court's decision threatened traditional insurance practices and the power of the States to regulate and tax insurance companies.

I have stated on numerous occasions, and I will state again that I am generally opposed to the grant of special exemptions from the antitrust laws. However, I am equally opposed to the Federal Government becoming involved in the regulation of insurance.

Although the proponents of the legislation argue that the States are free to regulate as they see fit, as a practical matter, because of the discrepancies in State regulation, the Federal Government will inevitably become involved if this legislation passes.

I do not believe that such intervention is best for the industry or the public.

Given the nature of the industry and the different needs of different geographical areas, I continue to strongly support State regulation. It is interesting to note that nowhere is State involvement as strong as it is in California, a State whose voters recently approved Proposition 103, which rolled back automobile insurance rates to their November 1987 levels.

Mr. Chairman, the insurance industry is clearly aware of the consumer concerns that have been raised. Just several weeks ago, the Insurance Services Office, known as ISO, announced that it would no longer publish advisory rates, but would only make available information concerning loss cost experience.

In addition, ISO will include on its board members of the public not affiliated with the insurance industry. I believe that the insurance industry needs to address consumer concerns, and that ISO's actions are a positive step in that direction.

Mr. Chairman, I want to thank all of the witnesses for their time and effort in appearing before us today. I intend to carefully review what they have to say, and I want to add this, too.

We have seen, in the last 40 or 50 years, attempts to bring more and more power to Washington. There is only so much power. Are we going to leave it where the Constitution put it, with the States and the people, chiefly, or are we going to continue to concentrate it in Washington?

I know of no authority for the Federal Government to be regulating insurance in this way. If we believe in federalism, true federalism—and that is that the Federal Government has only authority that has been delegated to it by the States—we won't go into this field.

The word "insurance" is not found in the Constitution. It has never been delegated to the Federal Government. Therefore, it has been reserved to the States.

As we go along, just because goals seem noble and worthy, we attempt to go into every field.

Many things are noble and worthy, but if you are going to do it, pass a constitutional amendment and do it properly. Otherwise, you should stay out of it. We should not attempt to do by statute what the Constitution doesn't permit.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you, Senator Thurmond. I guess I have to repeat again—I think maybe you came in a little late—that there is nothing that this Senator proposes that suggests, intimates, infers, or provides by legislation for Federal regulation. I have not made any such proposal, and my legislation specifically recognizes the right of State governments to regulate the industry of insurance.

Senator Heflin, do you have any opening statement?

OPENING STATEMENT OF SENATOR HOWELL HEFLIN

Senator HEFLIN. I have an opening statement that I ask be made part of the record. I think a lot of what is contained in the statement has already been articulated. I am interested in a little information pertaining to the Insurance Services Office, the ISO, the property and casualty insurance industry's largest data-gathering organization.

They just recently announced that they will stop providing advisory rates to participating companies, and the ISO also announced that it plans to open its board of directors to allow public members.

Arguably, this change will have a significant effect on carriers who may heavily rely on these advisory rates. Other members of the industry point to this event as a demonstration of good faith that they want to voluntarily police themselves, in addition to the matters pertaining to State regulation.

This would affect, I think, the bill in regard to the antitrust exemption as it stands now. I will be interested in hearing about this, as well as other matters.

[The prepared statement of Senator Heflin follows:]

STATEMENT OF SENATOR HOWELL HEFLIN
REGARDING THE MODIFICATION OF THE MCCARRAN-FERGUSON ACT

APRIL 18, 1989

MR. CHAIRMAN:

I AM PLEASED TO BE HERE TODAY TO LISTEN TO TESTIMONY REGARDING THE MODIFICATION OF THE MCCARRAN-FERGUSON ACT. I AM ESPECIALLY PLEASED BECAUSE ONE OF MY CONSTITUENTS, MR. TIMOTHY RUSSELL OF FOLEY, ALABAMA, WILL BE TESTIFYING BEFORE THIS COMMITTEE.

THE ISSUE OF PROVIDING AFFORDABLE, QUALITY INSURANCE TO INDIVIDUALS AND BUSINESSES IS EXTREMELY IMPORTANT. EVERY ONE HAS A DIFFERENT PERSPECTIVE AS TO HOW THAT GOAL CAN BE ACHIEVED, AND I LOOK FORWARD TO WORKING WITH THE CHAIRMAN AND THE OTHER MEMBERS OF THIS COMMITTEE IN STRIVING TOWARD THIS IMPORTANT GOAL.

Senator METZENBAUM. Thank you, Senator Heflin.
Senator Hatch.

OPENING STATEMENT OF SENATOR ORRIN G. HATCH

Senator HATCH. Well, thank you, Senator Metzenbaum. I am happy to be at this hearing today. This is an important issue, and we should have periodic reviews of the Act because of its importance to our antitrust laws.

As I have previously noted, shortly after I entered the Senate during the Carter administration I was appointed to serve on the National Commission for the Review of Antitrust Laws and Procedures.

During its consideration of the McCarran exemption, the Commission heard from its economic advisory panel that repeal of the Act would have little, if any, effect on price competition in the insurance industry. The Commission also affirmed that the special antitrust exemptions for the industry were warranted, and noted that the Act fostered competition.

Last Congress, after nearly 10 years since the Commission's review, we held hearings to examine the changes that had occurred in the insurance industry and to determine if changes in our antitrust laws were necessary.

As I stated at that time, I wanted to ascertain if the McCarran-Ferguson Act continues to promote intense and meaningful competition in the insurance business, and I looked at the issue with an open mind.

What I found was that the insurance industry is intensely competitive, and I concluded at that time that no changes in McCarran-Ferguson were, in fact, necessary. Little has changed since that time that would lead me to change my view. There are still several valid reasons for supporting the McCarran-Ferguson Act, and let me just list a few of them.

McCarran-Ferguson is one of a number of factors that has led to a strong competition in the insurance industry today. There are literally thousands of companies in the industry and the top five companies do not even account for 25 percent of the total insurance business of our country.

While there are currently few barriers to entry into this business, the loss of McCarran Act protections could mean it would be nearly impossible for new companies to compete or for older companies to stay in business.

Insurers, unlike almost any other business, must price their product without any knowledge of its true cost. Therefore, an insurance company's life depends on its ability to predict future losses in an uncertain economic and legal environment.

McCarran-Ferguson permits the sharing of loss data and cooperative pooling of excessive risks. These are just two activities which have probably benefited consumers, as well as insurance companies. Without the ability to conduct these matters, I don't think the consumers would have been benefited as much as they have.

I might say, without the ability to conduct the activities under the McCarran-Ferguson Act, small companies could not compete, which would result in a reduction of the currently strong level of

competition in the industry, not to mention the diversity of services to consumers.

McCarran-Ferguson has allowed for State regulation of the insurance industry. In the case of insurance, State regulation is better suited to the needs and interests of the consumer and the industry. To the extent that it reserves this power to the States, the Act is a good reflection of the federalism found in our constitutional system of Government, to which Senator Thurmond referred.

Federal regulation is generally cumbersome, slow, and unresponsive to local and individual needs. The States, on the other hand, have generally shown an ability to respond in a timely fashion to unexpected changes in the insurance market. Though not perfect, State regulation is certainly superior to Federal regulation both in terms of responsiveness to consumer needs and in terms of responsiveness to the insurance industry itself. It is certainly better than dual regulation by both Federal and State governments.

While the legislation before us today does not provide for Federal regulation, as Senator Metzenbaum has said, I believe that if we pass this bill, we will see a call for Federal regulation soon thereafter.

After more than 40 years of experience and court interpretation since its enactment, McCarran-Ferguson has worked. As we learned from several witnesses in the hearings held by the Judiciary Committee during the 100th Congress, the problems of availability and affordability of liability insurance appear to be due to factors other than the McCarran-Ferguson exemption. So it is working. Let us not try to change it when it is working.

Mr. Chairman, these factors have always shown the need for the McCarran-Ferguson exemption, but it is even more so now, given, as has been mentioned, the recent decision by the ISO, or the Insurance Services Office.

On April 3, ISO announced that it would stop providing advisory rates to its participating insurance companies. It will, however, continue to provide estimates of future loss costs, which is an estimate of average future loss payments, including costs for claims handling and legal defense.

Under the old advisory rates, in addition to prospective loss costs, insurance companies also received estimates for marketing and overhead expenses, underwriting profits, and contingencies.

Now, this is a significant change. According to the ISO press release earlier this month, they said, "Under the loss cost procedures, ISO's participating insurance companies will have to analyze the prospective expense provisions, select appropriate underwriting profit and contingency provisions, and develop their own rates. State law may then require individual insurers to file these rates with State regulators."

Now, Mr. Chairman, this step by ISO is a major step. I believe that it will directly affect the marketplace, and it addresses several of the concerns regarding McCarran-Ferguson that have been raised in the past. This step also heavily impacts on the question of whether or not we need to be making any changes in the law.

This is a responsible change which comes from within the industry itself. It removes the need to amend McCarran-Ferguson and, if nothing else, I believe we should give this new industry procedure

a chance to take effect before we decide if there are any additional steps that we in the Congress of the United States should undertake.

Just the same, I welcome the opportunity to hear from our distinguished witnesses today, and I join our chairman in expressing deep interest in what they have to say. So thank you, Mr. Chairman. I appreciate being able to make these remarks.

Senator METZENBAUM. Thank you, Senator Hatch. Senator Hatch, just to keep the record straight, I also served on that committee with you in the Carter administration, and it is my recollection that there were committees under both Ford and Carter. We both served on the Carter committee. Both of those committees concluded that repeal would be in the public interest.

If my recollection serves me right, and I am quite certain I am correct in this, didn't you actually dissent from that recommendation of the Carter Commission on Antitrust? I believe that you did.

Senator HATCH. My recollection is they didn't call for repeal of McCarran, but I will recheck that and make sure.

Senator METZENBAUM. I think it did.

Senator HATCH. I know that we did call for a number of other changes, to which I did dissent. But I am not sure that was—maybe you are right on that.

Senator METZENBAUM. I think I was on the prevailing side and you were not on that.

Senator HATCH. If that is so, once again, evil triumphed in a very important issue is all I can say. [Laughter.]

Senator THURMOND. Even if he did, he has learned better now. [Laughter.]

Senator METZENBAUM. I am very happy that Senator Kohl is with us this morning. Senator Kohl, do you have an opening statement?

OPENING STATEMENT OF SENATOR HERBERT KOHL

Senator KOHL. Yes. Thank you, Senator Metzenbaum.

Few in Congress have worked as diligently and as effectively as you to promote debate on insurance issues and the operations of the industry.

For most Americans, insurance is an essential part of our lives. We insure our health, our cars, our homes, and our businesses. Last year, Americans paid about $400 billion in insurance premiums, and that is more than 10 percent of our entire disposable income.

It is important, therefore, that an industry so vital to consumers serve the public well. But in the past few years, we have witnessed increasing customer dissatisfaction. Prices for some lines of liability insurance have gone sky high, and other types of commercial coverage have dried up entirely.

Though the causes of these dramatic availability and affordability problems are complex, they have clearly driven Congress 'interest in reviewing the McCarran-Ferguson Act. Proponents of repealing McCarran make several claims.

First, they contend that the Act shields the insurance industry from the brisk winds of competition. Second, the insist that the

vigor of State regulation varies erratically among jurisdictions. Third, they say that the industry no longer needs broad antitrust immunity because of recent developments in antitrust law.

Ultimately, they maintain that the long-term result of repealing McCarran will be more choices and lower prices.

As a former businessman, I am sympathetic to these arguments. I have always believed that our antitrust laws promote competition and that we shouldn't grant exemptions in the absence of compelling circumstances.

I am also aware that the American Bar Association recently advocated modifying McCarran in a manner consistent with Senator Metzenbaum's approach. But I also believe that we ought to proceed cautiously before we legislate rapid change in an industry that protects the financial stability of both individual consumers and our entire economy.

I recognize that insurers sell a product where the sale is made before the cost is actually known. This special circumstance may justify some special rules.

For all of these reasons, I look forward to this hearing as an opportunity to educate myself about the business of insurance. I want to thank all the witnesses for appearing here today, and I assure you that I am here to listen and to learn.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you, Senator Kohl.

Senator Grassley, we are happy to have you with us this morning.

OPENING STATEMENT OF SENATOR CHARLES E. GRASSLEY

Senator GRASSLEY. Thank you, Mr. Chairman.

Today's testimony marks another installment in what is fast becoming a biennial ritual of whether we ought to repeal or amend the insurance industry's limited antitrust immunity afforded by McCarran-Ferguson. I know that continued interest in this issue is prompted by a recent crisis of availability and affordability of insurance, though there are signs that the crisis is abating somewhat, and by the passage of Proposition 103 in California—of course, now that is under review in the courts—and also by the filing of an antitrust suit by numerous attorneys general against the insurance industry.

Most recently now, added to this crusade, the American Bar Association has weighed in with its own study, a 183-page document urging repeal, which landed with a thud a month ago.

The sponsors of this legislation, which is attractively styled the Insurance Competition Improvement Act, have put together an impressive coalition of supporting groups. Anybody who knows how to get things done in Washington would recognize that.

From my review of prior testimony, it appears that the supporters fall into two groups, each with separate and distinct motivations. One group comprises those who, while supporting State regulation of insurance, believe in completely free markets.

Though they acknowledge the competitiveness of the insurance business under McCarran-Ferguson, including strong evidence of low concentration levels, low entry barriers, rampant price-cutting,

et cetera, these individuals believe that even such limited industry activity as establishing advisory rates violates antitrust laws.

Now, the fact that such activity actually benefits small insurers, creates markets that would not otherwise exist, permits innovations and flexibility that could not be otherwise accomplished, and actually increases competition, of course, is of no apparent interest to these purists.

The other group seeking to repeal or amend McCarran does so not out of a desire to increase competition, but rather simply to increase regulation, particularly Federal regulation. The result is likely to be fewer competitors or the passage of new forms of State regulation, either of which will reduce the availability of insurance or raise prices.

Ironically, the insurers who will be hurt the most are the small companies, those who are theoretically supposed to benefit from vigorous enforcement of the antitrust laws. Small firms, because they lack an adequate data base, depend on the loss data and the analyses performed by rating organizations.

If access to this information is no longer permissible, smaller local and regional companies or companies serving limited markets would no longer be able to survive. The same is true for new companies and those entering new lines of business. I am especially sensitive to this concern because of the effect on the many small and rural insurance providers in my State.

Most economists, and even the Supreme Court, have acknowledged that the settled goal of antitrust law is to maximize consumer welfare. Yet, in addition to the adverse impact on thousands of employees of small insurers caused by this legislation, consumers could be hurt as well.

For example, standardized policy forms currently allow consumers to comparison-shop because they know that they will be purchasing the same basic policy from each company. Standardized forms and sharing of loss data allow the industry to be more efficient and more competitive.

Yet, each may be banned by this legislation.

This translates into higher costs for consumers, more chance for confusion or abuse, and less efficient State regulation. Advocates respond by saying that such joint activities may still be eligible for the so-called "State action" antitrust immunity.

Yet, this legal doctrine is a recipe for even more regulation, as it requires the States to enact the most restrictive forms of regulation.

Any Federal amendment to McCarran that attempts to define specific exemptions will have to spell out every permissible activity. This approach is problematic for at least two reasons.

It will thwart insurer innovations outside the legislatively-created "safe harbors" and, worse, it will be an engraved invitation to costly and lengthy treble damage litigation over newly-created insurer activities.

Are our Federal courts in need of more complex litigation? Assuredly, the answer is no. Will policyholders pay for this litigation through higher premiums? Most assuredly, the answer is yes.

I will stipulate to the fact that no system of regulation is perfect, nor does every State enjoy the benefits of an effective regulator

such as my own State of Iowa. However, on balance, the regulation of the business of insurance is best left to the States, with a limited antitrust exemption. Together, these two concepts will permit the best chance for a competitive and well-regulated insurance market.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you, Senator Grassley. I would like to point out to you, just in case you overlooked it, because I know you are concerned about the small companies, that we do provide in this legislation for safe harbors for joint underwriting arrangements and residual market mechanisms, for collection of historical loss data, for exchange of information regarding fraudulent claims, for preparation of standardized forms, and for joint research for public fire defenses.

So we have attempted to provide a legitimate exemption for certain activities, and I will say to you that if you think that there is some area that we have not covered that is legitimate, we are perfectly prepared to discuss with you the need for an additional or some clarification of the safe harbor.

But I also would point out to you that nothing in the bill, as I have repeated previously three, four, five times, provides for State regulation. But I appreciate the fact where you talk about how you approve of the idea of limited antitrust exemption. Maybe there is some area for discussion in that comment of yours, and I appreciate your participation.

Senator GRASSLEY. I suppose any Act that is 50 years old may be one to reconsider, but I think the problem you are going to have is, when you start making exemptions, with the complexity of the insurance industry, if you don't include every activity, you are going to create a major problem by excluding others. I simply don't think you can write general legislation well enough to accomplish your goal.

Senator METZENBAUM. Try us.

Senator GRASSLEY. OK.

Senator METZENBAUM. Try us.

Senator Simpson, we are happy to have you with us here this morning. It is indeed a privilege to see you, sir.

Senator SIMPSON. It is good to see you, Senator Metzenbaum. I enjoy always spirited times with you, indeed.

Senator METZENBAUM. I have been waiting for a convert from that side of the aisle, and it is so good to see you.

OPENING STATEMENT OF SENATOR ALAN K. SIMPSON

Senator SIMPSON. Why, you—oh, no, excuse me. [Laughter.]

Well, I don't have my cushion, so if I sink down and just disappear from sight here, don't worry. I feel like I am in the second grade.

Well, Mr. Chairman, as I say, you are a spirited individual. You are a man who believes in his causes, and from that has come an admiration which I think is mutual, even though you and I do love to kind of scratch around in it; at least I do, and you do. You give as good as you get.

This is a tough issue, and I know you have wanted to do something in this area a long time by further limiting this antitrust ex-

emption provided to insurance companies. We have considered that a lot of times in my 10 years in Congress, and I know that you have been in the forefront of that.

I continue to be of the opinion that it is an unsound idea, and obviously, as you have continued to tailor the measure over the years, you do remove every once in a while some marvelous pocket of opposition, which is very interesting.

But in my mind, I still think the States should establish their own system, and you have gone into a recognition of that, in a way. I do not think it would be appropriate to eliminate State oversight or to create a dual system of State and Federal oversight.

I still think that State insurance commissioners are in a better position than the Federal Government to make these judgments regarding the solvency of companies and other matters.

But, you know, the industry has gathered this data over the years, ostensibly, and saying that it determines risk and establishes risk and establishes premium rates. But individual companies have been left on their own in deciding what specific premiums to charge.

It has given us competition. There are 3,500 companies in the property/casualty insurance industry alone. It is a competitive industry, but I do think that modification of McCarran-Ferguson would not increase competition. I think, in fact, it would be a benefit to the very largest companies who have their own in-house capacity to create their own data base, and the small or medium-size companies just would not have the ability to provide that kind of research as easily as the others. Therefore, a change as suggested, I think, would really further harm that part of the industry.

Mr. Chairman, I hope to participate in a bit of this today and as you go forward, but I think we should all be aware of the recent actions taken by the ISO, the Insurance Services Office. They made their own decision to dramatically change the information they provide to member insurance companies.

No longer will ISO share its data on office expenses and profit margins. It is going to limit itself to estimates of future loss payments, and that action by ISO will dramatically affect the 1,400 participating insurance company members. That is in alignment with the recommendation of the National Association of Insurance Commissioners.

Although I have some real concerns, as I think Senator Grassley does, as to the effect of this action on small and medium-size companies, I believe it is a step in the right direction and addresses industry and public policy questions.

So, Mr. Chairman, I guess I would just say, now that the ISO has made that decision, for whatever reason, let us give the industry an opportunity to sort out the effects. I don't think it is time to now come in and confuse the insurance market through modification of McCarran-Ferguson.

The industry is going to undergo some tremendous changes in the next several years because of the changes in ratemaking. Let us see what happens. We might find that even more companies are entering the field. We might find that the small and medium ones are dropping out because they are unable to create their own data base necessary for profitable business.

But the point is we won't know in the short term and we have to give the changes an opportunity to work.

So I appreciate the opportunity to make these few comments. I will be interested in hearing the testimony of the witnesses, but I trust that we will proceed very cautiously on any of the changes proposed, and I thank the chairman.

Senator METZENBAUM. I thank you, Senator Simpson, and I might say that I, too, appreciate the fact that the ISO has changed their position. I think that reflects the winds of change that are blowing across this country with respect to insurance matters. I think it is a step in the right direction. I don't think it is as far as should be gone, and I believe that all industries ought to be treated equally in this country and none should be exempt from the antitrust laws.

Now, having said that, it seems to me Senator Hatch did some research to see whether or not he did indeed dissent.

Senator HATCH. Once again, you are right, Mr. Chairman, and I am wrong. They did recommend repeal of McCarran-Ferguson. However, they did say that that would not help competition, and that is where I got mixed up. But you are right that that is so.

Senator METZENBAUM. Thank you.

Senator HATCH. I just wanted to check it and correct the record to make sure. So the point that we made, though, is still a valid one that they did not feel that it would basically change competition.

Senator METZENBAUM. Thank you very much, Senator Hatch.

Senator Simpson, as you pointed out, this is not the first time I have come to the Senate with this legislation, and I have a happy announcement to make today for all the insurance company lobbyists. If I don't get it through this session, I will be back with it next session. I have got six more years to keep working on it.

Senator HATCH. And he will be just about as successful then as he is this time.

Senator METZENBAUM. Our first panel consists——

Senator THURMOND. Mr. Chairman, one thing you are doing, you are giving a lot of employment to these lobbyists around here.

Senator METZENBAUM. Yes, sir, I certainly am.

Senator THURMOND. That sort of helps the economy, I guess.

Senator METZENBAUM. Before I call the first panel, I wish to place a copy of S. 719 in the record.

[The text of S. 719 follows:]

II

101ST CONGRESS
1ST SESSION

S. 719

To amend the McCarran-Ferguson Act to limit the Federal antitrust exemption of the business of insurance, to reaffirm the continued State regulation of the business of insurance, and for other purposes.

IN THE SENATE OF THE UNITED STATES

APRIL 6 (legislative day, JANUARY 3), 1989

Mr. METZENBAUM (for himself, Mr. SIMON, Mr. BIDEN, and Mr. KENNEDY) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

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A BILL

To amend the McCarran-Ferguson Act to limit the Federal antitrust exemption of the business of insurance, to reaffirm the continued State regulation of the business of insurance, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Insurance Competition Improvement Act of 1989".

FINDINGS AND DECLARATION OF PURPOSE

SEC. 2. (a) The Congress finds and declares that—

(1) the continued regulation and taxation by the several States of the business of insurance is in the public interest; and

(2) the Federal antitrust laws comprise an essential component of congressional policy in favor of competition and consumer protection, and the current broad exemption from the antitrust laws afforded the insurance industry has adversely affected free competition and consumers of insurance.

(b) It is the purpose of this Act to promote free competition among insurers and to protect consumers of insurance by modifying the current antitrust exemption of the business of insurance.

AMENDMENTS TO THE MCCARRAN-FERGUSON ACT

SEC. 3. (a) The first section of the Act entitled "An Act to express the intent of the Congress with reference to the regulation of the business of insurance", approved March 9, 1945 (15 U.S.C. 1011), commonly known as the McCarran-Ferguson Act, is amended by striking out the period and inserting in lieu thereof the following: "; but that a continued broad exemption of the business of insurance from the Federal antitrust laws is not in the public interest.".

(b) Section 2(b) of the McCarran-Ferguson Act (15 U.S.C. 1012(b)), is amended by striking out all after "insurance" the second place it appears and inserting in lieu thereof a period.

(c) Section 3 of the McCarran-Ferguson Act (15 U.S.C. 1013) is amended to read as follows:

"SEC. 3. (a) Except as provided in subsections (b) and (d), the antitrust laws shall apply to the business of insurance and to acts in the conduct of such business.

"(b) The antitrust laws shall not be construed to prohibit any agreement, understanding, or concert of action between or among insurers, any insurance advisory organizations or their members, any individual insurers or any other persons that is limited to—

"(1) collecting, compiling, and disseminating historical data on paid claims or reserves for reported claims from insurers or any other source, provided that such information is made available to an appropriate State regulatory agency;

"(2) preparing and filing policy forms and endorsements for voluntary use by individual insurers, provided that such forms do not include benefit levels;

"(3) conducting research and on-the-site inspections in order to prepare classifications of public fire defenses; and

"(4) collecting, compiling, and distributing information relating to fraudulent claims and other fraudulent practices, provided that such information is made available to an appropriate State regulatory agency.

"(c) Nothing in this Act or any State law shall render the antitrust laws inapplicable to any agreement to boycott, coerce, or intimidate, or to any act of boycott, coercion, or intimidation.

"(d) Insurers and other persons participating in joint underwriting, pools, or residual market mechanisms may, in connection with such activity, act in cooperation with each other in the making of rates, rating systems, policy forms, underwriting rules, surveys, inspections, and investigations, if the residual market mechanism is required by law or is approved by and subject to the active supervision of an appropriate State regulatory agency, or if the joint underwriting or pools do not unreasonably restrain trade.

"(e) Nothing in this Act shall be construed to prohibit any State from establishing or approving a residual market mechanism.

"(f) Nothing in this Act shall be construed to prohibit any State from requiring a worker's compensation and employers' liability insurer to adhere to the uniform classification system and uniform rating plan applicable to these categories of insurance in such State, but no such insurer shall agree with any other insurer or with an insurance advisory organization to adhere to or use any rate.

"(g) As used in this section, the term—

"(1) 'advisory organization' means any organization which is comprised of, or is controlled by, one or more insurers and which prepares policy forms and endorsements for use by its members or subscribers, compiles and promulgates insurance-related statistical data, prepares and revises insurance rating plans and classification systems, and provides assistance in the preparation of insurance rates;

"(2) 'antitrust laws' means the Sherman Act (15 U.S.C. 1 et seq.), the Clayton Act (15 U.S.C. 12 et seq.), and the Federal Trade Commission Act (15 U.S.C. 41 et seq.);

"(3) 'residual market mechanism' means an arrangement, either voluntary or mandated by law, involving participation by insurers in the equitable apportionment among them of insurance which may be afforded applicants who are unable to obtain insurance through ordinary methods;

"(4) 'joint underwriting' means a voluntary arrangement established on an ad hoc basis to provide insurance coverage for a commercial individually rated risk under which two or more insurers contract with the insured at a price and under policy terms agreed upon between the insurers, or negotiated between the underwriter and the insured; and

"(5) 'pool' means a voluntary arrangement, other than a residual market mechanism, established on an ongoing basis, under which two or more insurers participate in the sharing of risks on a predetermined basis by means of an association, syndicate, or other pooling agreement.".

SEC. 4. (a) This Act and the amendments made by this Act shall become effective one year after the date of enactment.

(b) In any action brought under the provisions of the antitrust laws alleging a violation of those laws for conduct that would have otherwise been lawful under the provisions of the McCarran-Ferguson Act on the day before the effective date of this Act, no award of treble damages or criminal penalties shall be awarded against any such person for conduct by such person occurring within two years after the date of the enactment of this Act.

(c) During the two-year period referred to in subsection (b), no relief shall be granted against any person in an action referred to in subsection (b) for conduct by such person during such period, if such person has, in good faith, relied upon an advisory opinion issued by the Department of Justice.

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Senator METZENBAUM. Charles Brown, attorney general of West Virginia, speaking for the National Association of Attorneys General, from Charleston, WV; and Earl Pomeroy, vice president of the National Association of Insurance Commissioners and Commissioner of Insurance for North Dakota, accompanied by Robin Campaniano, Insurance Commissioner of Hawaii.

I think that the witnesses know that the committee rules—or, rather, this chair's rules provide for a 5-minute statement. All of the written statements will be included in the record.

Mr. Brown, I am always glad to see you. As you know, your brother is the secretary of our State and a very good friend of mine, and we are happy to see you again.

STATEMENT OF A PANEL CONSISTING OF CHARLES G. BROWN, ATTORNEY GENERAL, STATE OF WEST VIRGINIA, ON BEHALF OF THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL, CHARLESTON, WV; AND EARL R. POMEROY, VICE PRESIDENT, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, AND COMMISSIONER OF INSURANCE, STATE OF NORTH DAKOTA, ACCOMPANIED BY ROBIN CAMPANIANO, COMMISSIONER OF INSURANCE, STATE OF HAWAII

Mr. BROWN. Well, Mr. Chairman, thank you, and when I was a college student I ran your campaign on my campus and I am very happy to have you here in the Senate the way you have served for many years, but we are happy to appear in front of all the Senators today.

The National Association of Attorneys General believes that it is time to repeal the immunity for insurance from the antitrust laws. Exemptions have to be heavily disfavored in antitrust laws, as Senator Thurmond capably pointed out. There is just no room for industries who say, we are different, we are special, we are the ones that should be immune, should be privileged, whereas everybody else out there, the rest of you, should have to compete.

The National Association of Attorneys General has supported an outright repeal. Senator Metzenbaum's bill is drawn a little more carefully than that, but we certainly are here to speak in favor of that bill.

No one should be allowed to fix prices. There are other exemptions in the antitrust laws which your committee has crafted over the years, some of which have been opposed by the attorneys general, but all of which are pretty narrow in their scope.

But this is the only industry I know of which can fix prices, legally. That is the difference, unlike others where you have territorial issues or failing companies with newspapers and other things that probably aren't good ideas, but this is the worst idea because it gets at the core area of antitrust, price-fixing, and says that this industry will be allowed to sit down and agree on the prices they are going to charge the public. That is the area we have got to focus on if we are going to have a competitive insurance industry and a competitive American economy.

The practices of the insurance industry have certainly added fuel to this debate. In my home State, in West Virginia, in 1986 the medical malpractice companies simultaneously pulled out of our

State. The act would have, in fact, brought the whole health care industry to its knees.

We were about to see the shutdown of baby doctors, clinics, kidney dialysis units, all the primary care services that our State so badly needs—a rural, lower-income State. The supreme court of our State, however, did grant an injunction in the antitrust case I filed and we were able to solve that problem.

There is also, as Senator Metzenbaum pointed out, a case by 19 States aimed at other insurance industry abuses. Now, the legislation being considered here is a different matter. Our case in Federal court in San Francisco pertains to practices already prohibited under Federal law, under our definition of the law.

I might add that the insurance industry, as I talk to staff people, I believe, is representing to the committee that the boycott exemption in the law is very broad. In the Federal court under the pleadings, they are representing that the boycott exemption is very narrow; that is, only a few activities are prohibited. Here, they seem to be talking much broader. We will certainly let the court decide what boycott means in San Francisco. We think it covers the practices that were done; that is, we think the practices were illegal.

Businessmen and women in West Virginia continue to say to me, why is insurance different? Why am I prohibited from fixing prices in my trade or profession, but the insurance industry can go ahead and do that?

I think that is part of the movement taking place. This isn't just a movement by AARP and labor groups and consumer groups and the attorneys general. The business community has gotten so involved in repeal—bankers, health care providers, the Automotive Service Association and other associations.

All kinds of people are saying let us repeal this Act and let us create the level playing field that we live under. When we buy insurance, we small business people, we business people of any size, we would like a level playing field for people who are in business.

I note, and I am very pleased to see, that ISO has said no more advisory rates. This is a major step forward by the insurance industry. The ISO has said we will no longer have these advisory rates.

I take it, then, there are only two meanings of this, either, one, the industry is really not so opposed to what Senator Metzenbaum wants to do—Senators Metzenbaum, Simon, Kennedy and Biden—because we are simply trying to stop these types of practices that have gone on for years. That is certainly one approach.

I think the industry should either say we are going to support the bill, or else they are saying, gee, if you guys take the heat back off, we are going to put the advisory rates back on. Let us not allow them to come back. Let us keep the movement going toward legislation, legislation that I think they would probably be much less likely to oppose. And if they do continue to oppose it, I would suggest that the industry is considering bringing the advisory rates back when the hearings end, when all the tension ends from the attorneys general, the Senate, and others.

Mr. Chairman, thank you very much.

[The prepared statement of Mr. Brown follows:]

STATEMENT OF CHARLES G. BROWN
ATTORNEY GENERAL OF THE STATE OF WEST VIRGINIA

Good morning. Thank you, Mr. Chairman. I appreciate being here today to offer my testimony in support of Senator Metzenbaum's bill calling for the repeal of the special exemption to our nation's antitrust laws that the insurance industry currently enjoys.

I support the Senator's initiative for the withdrawal of the antitrust exemption contained in Section 2(b) of the McCarran-Ferguson Act. (15 U.S.C. § 1012(b))

INTRODUCTION

It would appear that history really does repeat itself and sometimes very quickly indeed. Two times in the past decade, state and federal government has been involved in examining the so-called "liability insurance crisis." We know that extreme volatility in the availability and affordability of insurance disrupts the stability of our commercial enterprises and strikes at the economic welfare of our households and families. The American insurance industry is truly a vast empire with significant economic power. Shock waves from this industry touch every sector of our economy.

In 1985 the total assets of this industry in the United States totalled more than $1.13 trillion dollars.[1] That is an amount that is as great as our national budget. And the property/casualty segment of the insurance industry is alone responsible for a third ($311.3 billion) of these assets. In 1986, the industry collected over $300 billion in total premiums for life/health[2] ($116 billion)/and property/casualty insurance ($176 billion).[3] On a per capita basis, that is almost $1400 in premiums for every man, woman and child in this country.

There is no doubt that the volatility in this industry that we have all witnessed and experienced over the past decade is properly the subject of government scrutiny. This scrutiny has raised serious questions about the relationship between insurance industry conduct and the immunity it enjoys from the antitrust laws. I maintain that the antitrust exemption is a primary cause of the industry's periodic episodes of unavailability and skyrocketing rates. At a minimum, however, collective responses by the industry to real or perceived economic problems certainly focus attention on the industry's broad immunity from antitrust exposure.

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[1] Insurance Information Institute, Insurance Facts, at preface, (1986-87).

[2] Cite -Pamela

[3] Bests Review and Preview, 1987, p.12.

I believe that an examination of the record reveals: (1) that the antitrust exemption fosters certain collective conduct that produces little, if any, public benefit; (2) that the exemption does not appear to contribute to industry stability or reasonable rates; (3) that the development of state action and commerce clause doctrines have rendered whatever initial rationale there was for the exemption obsolete; and (4) that joint industry activities authorized by the state or that are otherwise efficiency enhancing and procompetitive can be carried on without the exemption.

I.

Historically, Congress has granted antitrust immunity to industries under limited circumstances when there is compelling evidence that competition will not work. Under those circumstances, Congress balances the benefits to the public against the costs of authorizing what would otherwise be anticompetitive conduct.

Certainly, even before passage of the McCarran-Ferguson Act, a primary rationale for insurance industry regulation by the states was that vigorous competition would lead to inadequate premium rates and eventually to the insolvency of insurance companies.[4] It was believed that this competition would injure

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[4] Kinter, Bauer, and Allen, Application of the Antitrust Laws to the Activities of Insurance Companies: Heavier Risks, Expanded Coverage, and Greater Liability, 63 North Carolina L R 433 at 434 (1985).

policyholders as well as the companies themselves and result in tremendous instability in the market.[5] Thus, it was important for rates to be compensatory, but not excessive. Clearly, the McCarran-Ferguson Act, with its emphasis on continued state regulation and its exemption from the antitrust laws, should result in furthering the goals of industry solvency and stability to the ultimate benefit of the public welfare. Has the industry's antitrust exemption contributed to stability in the availability of insurance at reasonable rates?

Let's look at some of the record from the past decade:

-- Across the country, entire lines of insurance have been cancelled or subject to nonrenewal.

-- Within the past four years many states have experienced a total walkout by carriers providing coverage for certain lines of insurance. [GIVE ANECDOTES FROM ST. PAUL CASE];

-- West Virginia's cities and towns have had to turn to a state-run self-insurance pool in order to obtain liability coverage because carriers stopped providing municipal liability insurance;

-- Hazardous waste facilities have found liability insurance to be unavailable;

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[5] Id.

-- Construction contractors, human service providers, recreation and sports facilities have all experienced serious problems in securing general liability insurance coverage;

-- The conduct of insurance industry trade associations reflects a cavalier attitude toward the public welfare that is absent in industries subject to antitrust scrutiny. For example, what other industry collectively threatens to withdraw its goods or services unless state regulators accept its standard form contracts?

When we look at even a partial record of collective activity by the insurance industry, it is clear that ordinary benefits that are supposed to inure to the public from an industry exempt from the antitrust laws -- such as stability and reasonable rates -- are simply not present. The fundamental rationales for providing antitrust immunity in the first instance are lacking. It is clear that the beneficiary of the insurance industry's antitrust immunity is not the public, it is the industry.[6] While I am not suggesting that withdrawing the industry's immunity is a panacea for all problems, it is clear that the existence of the immunity is not providing the public with a stable industry selling its service at affordable rates.

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[6] Data on profitability from GAO report.

II.

I believe that developments since passage of the McCarran-Ferguson Act render obsolete any need the industry ever had to be exempt from the antitrust laws. Moreover, it appears that the industry's antitrust immunity may have been something of an historical fluke in the first place that was erroneously linked with the states' rights to regulate and tax the industry. A brief historical review underscores this point.

During the 19th and early 20th centuries, the insurance industry actively sought relief from existing state regulatory schemes through federal legislation.[7] Bills were introduced in Congress to create a national bureau of insurance.[8] to rescue the insurance industry from what it regarded as the burdens of state taxation and regulation. When the industry failed to create a federal regulatory regime, it attacked the problem of state regulation through the courts. These efforts culminated in the famous test case of Paul v. Virginia, 75 U.S. (8 Wall), 168, (1869), where the industry sought judicial determination that federal regulation would apply to its conduct. The test case

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[7] See generally, Michael D. Rose, State Regulation of Property and Casualty Insurance Rates, 28 Ohio State Law Journal 669 (1967).

[8] S.299 40th Congress, 2d Session (1868); H.R. 738, 38th Congress, 1st Session (1866).

backfired, however, and the Supreme Court in dicta stated that the business of issuing insurance policies was not interstate commerce. Thus, state and not federal law would apply to the insurance industry. Insurance companies continued to oppose state regulation by supporting more legislation, including a constitutional amendment, to achieve federal regulation.

This attitude toward federal regulation changed abruptly and dramatically after the 1944 Supreme Court decision in United States v. South-Eastern Underwriters Association (SEUA), 322 U.S. 533, which held that insurance was indeed interstate commerce and subject to federal antitrust laws.[9]

In the wake of SEAU, there was alarm and concern about how and by whom the insurance industry should be regulated. There was immediate concern that if the insurance industry was indeed in interstate commerce, the states might be preempted from licensing, regulating, or taxing the industry. In the scramble and confusion that followed, Congress passed the McCarran-Ferguson Act as we know it today.

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[9] SEUA was brought by the Justice Department against an association of 200 fire insurance companies charging them with conspiratorial fixing of rates and agent commissions. The case developed after the Missouri attorney general brought the complaint to federal authorities.

If one rummages through the legislative history of the Act, as a number of states have done recently, one finds little record of debate concerning the costs to the public of immunizing the insurance industry. In other words, the usual discussion about balancing the costs of restricting competition against the benefits to the public interest of such restrictions are virtualy absent. Instead, what is found is almost a total preoccupation with the need to pass legislation quickly to guarantee that the states could continue to regulate and tax -- and especially tax -- insurance companies.

Immediately after the SEUA decision, many companies refused to pay licenses and taxes in many states. So it is easy to appreciate the pressure on Congress to act and to act decisively. The legislative history shows a deep concern that the proposed legislation not be interpreted as an implicit repeal of the states' rights to regulate and tax. Congress was concerned that the continued application of the antitrust laws would be used to invalidate state laws regulating insurance.

We believe that this concern though perhaps understandable at the time was, nonetheless, unfounded. This view was shared and expressed at the time by President Franklin Roosevelt who wrote to one of the senators who was advocating such legislation:

> The responsibility for the regulation of the business of insurance has been left with the States and I can assure you that this administration is not sponsoring Federal legislation to regulate insurance or to interfere with the continued regulation and taxation by the States of

> the business of insurance. But there is no conflict between the application of the antitrust laws and effective State regulation of insurance companies and there is no valid reason for giving any special exemption from the antitrust laws to the business of insurance. The antitrust laws prohibit private rate fixing arrangements between insurance companies and acts of boycott, coercion or intimidation. The antitrust laws do not conflict with affirmative regulation of insurance by the States such as agreed insurance rates if they are affirmatively approved by State officials.

91 Cong. Rec. Senate, 482 (1945), (emphasis added).

Events subsequent to the passage of the McCarran-Ferguson Act show the wisdom of President Roosevelt's words.

1. The year after the Act was passed, the Supreme Court held that California's insurance regulations designed to weigh more heavily on out-of-state insurers did not violate the commerce clause, Robertson v. California, 328 U.S. 440 (1946). Today, it is clear that the Commerce Clause does not interfere with a state's ability to tax or regulate any line of commerce, so long as the state's action does not impede the flow of interstate goods, Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978), or unduly discriminate against interstate commerce.[10]

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[10] See, e.g., Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333 (1977); Dean Milk Co., v. City of Madison, 340 U.S. 349 (1951).

2. When the McCarran-Ferguson Act was passed, the state action doctrine established by Parker v. Brown, 317 U.S. 341 (1943), was barely one year old. It is interesting and prophetic, however, that the Supreme Court in SEUA cited Parker after stating that "the argument that the Sherman Act necessarily invalidates many state laws regulating insurance we regard as exaggerated," 317 U.S. at ___. Since the passage of the Act, the parameters of the state action doctrine have been expanded greatly and its application to state insurance laws and regulatory schemes cannot now be in doubt.

Under the state action doctrine if a state authorizes and supervises otherwise anticompetitive conduct by private parties, the conduct is immune from antitrust exposure.[11]

The recent trend in state action cases has been one of greater judicial deference toward state regulatory policies.[12] As long as the state has determined to displace competition with a regulatory regime, the Supreme Court has held that a private defendant "need not 'point to a specific, detailed legislative authorization' for its challenged" conduct.[13]

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[11] See, e.g., Southern Motor Carriers Rate Conference (SMRC) v. U.S., 471 U.S. 48 (1985); California Retail Liquor Dealers Association v. Midcal Aluminum, Inc., 445 U.S. 97 (1980).

[12] See Merrick B. Garland, Antitrust and State Action: Efficiency and the Political Process, 96 Yale LJ 486 (1987).

[13] SMCRC at 64.

Thus, in retrospect, it appears as is the case so often with hurried or emergency legislation, many of the reasons originally advanced in support of McCarran-Ferguson were false alarms. The ability of the states to regulate and tax the insurance industry is in no way dependent on the industry's exemption from the federal antitrust laws.

In a sense, we have come full circle. It has been 120 years since the famous Paul v. Virginia case. The insurance industry is still subject to state regulation and taxation and at the same time, it is virtually free from federal antitrust exposure. The major difference today is in the posture of the industry. The industry no longer seeks uniform federal regulation; the industry now seems content with regulation by over 50 different jurisdictions. At the same time, it seeks to retain immunity from federal antitrust standards. The reason for this posture may very well be the built-in advantages afforded by lack of comprehensive oversight and national accountability.

In many states, there is no or little state participation in ratemaking by the insurance industry. In these states, the industry is essentially getting a free ride. In the absence of effective state regulation, the industry enjoys the anomalous result of neither federal or state law actually regulating its activities -- thus leaving the public unprotected.

III.

There are those who argue that in the absence of antitrust immunity, the insurance industry will not be able to engage in many of the joint activities necessary to its continued viability. Generally, these claims are exaggerated, although they do have a familiar ring especially to this subcommittee. They are similar to the arguments advanced by other industries, such as trucking and rails, when they were trying to retain their special treatment under the antitrust laws.

1. RATES AND RATEMAKING

If the McCarran-Ferguson Act exemption is repealed, the rate making process would be subject to Section 1 of the Sherman Act in the absence of a state regulatory scheme that authorizes collective ratemaking. As I discussed above, however, the state action exemption has been interpreted very broadly by the Supreme Court in this area, and will be available in most state ratemaking settings.[14] Basically, as long as the regulation represents a clearly articulated state policy, and, as long as the state supervises any private anticompetitive conduct, the regulation will be free from antitrust review. Southern Motor Carriers Rate Conf., supra.

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[14] Since mid-1982, the Court has upheld against antitrust attack all five state or local regulatory schemes that have come before it. See, Fisher v. City of Berkeley, 106 S. Ct. 1045 (1986); Southern Motor Carriers Rate Conf. v. United States, 471 U.S. 48 (1985); Town of Hallie v. City of Eau Claire, 471 U.S. 34 (1985); Hoover v. Ronwin, 466 U.S. 558 (1984); Rice v. Norman Williams Co., 458 U.S. 654 (1982).

As a result, in the rate instance where there is no articulated state policy, adopting agreed upon rates would no longer escape antitrust scrutiny. Even this rare instance may have been eliminated by the Insurance Services Organization's recent decision to end its price-fixing activities.[15]

2. POOLING OF STATISTICAL DATA

In the life/health insurance area, the repeal of the McCarran-Ferguson Act will have substantially no effect on the information exchange necessary for that industry. Life expectancy tables and health data are readily available.[16]

The question is somewhat more complex for the property/casualty underwriters who have engaged in cooperative assembling of loss statistics. It is not unusual for the industry's "rating bureau," the Insurance Services Office (ISO), to collect the loss data and then to "recommend" rates aimed at achieving certain overall profit margins. While the exchange of

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[15] Lisa S. Howard, "ISO: No More Advisory Rates," National Underwriter, April 10, 1989, p.1.

[16] In 1979, the National Commission for the Review of Antitrust Laws and Procedures concluded that there was no justification for continued immunity in this area. 1979 Report to the President and the Attorney General at p. 65.

loss information through a rating bureau, would not in itself be illegal, (Maple Flooring Manufacturing Association v. United States, 268 U.S. 563 (1928), the "recommendation" of rates by ISO would pose antitrust concerns, unless such conduct was authorized by the state. There is no reason, however, why an individual property/casualty company cannot set its own rates unilaterally, based on industry loss data.

3. STANDARD POLICY FORMS AND STANDARDIZED COVERAGE

Generally, standard contract forms do not violate the antitrust laws, as long as their adoption by individual business is voluntary, and as long as use of standard forms does not facilitate unauthorized pricefixing or output restrictions among competitors. In the same vein, collecting data to facilitate standard risk classifications, a legitimate data collection function, would also not violate antitrust laws, as long as the adoption of the classification system was voluntary and not used for anticompetitive purposes. Moreover, the state action exemption will apply in this area in states where the current regulatory scheme includes the approval of policy forms by the state insurance commission.

4. JOINT UNDERWRITING AND JOINT INSURANCE

Insurance pools are voluntary inter-company risk-sharing arrangements which provide insurance or reinsurance coverage for specific types of risks which are not usually handled by individual insurers. Insurance pools also provide a means by which special classes of insureds can receive reduced rates which they would be unable to receive from individual companies. Property casualty insurers have traditionally shared large risks through pooling and reinsurance.

Increasingly, state administered insurance pools, known as Joint Underwriting Associations (JUA) are being established. Where the pools are established and run by the states, the state action exemption will apply to antitrust challenge.

The antitrust exposure of private voluntary pools, on the other hand, will be tested under the laws applicable to joint ventures. A joint venture is a joint business undertaking by two or more parties who share both the risks and profits of the business. The risk sharing aspects of commercial and industrial joint ventures resemble the insurance pools described above.

Joint ventures have become more commonplace among U.S. businesses and are often utilized by businesses that do not receive any special antitrust immunity. Such ventures are by no means inherently illegal under federal antitrust laws. The conduct will be subject to antitrust exposure, however, if the

effect of the venture is to foreclose actual or potential competition between its participants or other potential or existing competitors in the market. Citizens Publishing Co. v. U.S., 394 U.S. 131 (1969); U.S. v. Penn-Olin Chemical Co., 378 U.S. 158 (1964).

For companies contemplating joint ventures, an often used vehicle for avoiding potential exposure is the Department of Justice Business Review procedure. Under this procedure, companies anticipating business arrangements with a potential antitrust problem may request a statement of enforcement intentions from the DOJ on the prospective conduct. The DOJ Business Review procedure will be a good vehicle for resolving concerns involving the continuation of joint activities after the repeal of antitrust immunity.

CONCLUSION

Attorneys General across the nation have added their voices to those calling for the repeal of the insurance industry's antitrust immunity. This is not a new call. Twelve years ago, a 1977 Report of the Antitrust Division of the Department of Justice concluded that the insurance industry:

> should be able to conduct its business without any special exemption from the federal antitrust laws. Antitrust precedent indicates that insurance companies could pool their loss experience through a statistical bureau consistent with federal antitrust standards. Moreover, the federal antitrust laws would not prohibit any necessary trending of future losses on a composite basis by advisory organizations that were independent of

> the companies they were serving. Likewise, the antitrust laws would not prohibit those voluntary risk-sharing arrangements, such as insurance pools and reinsurance agreements, that were either necessary to the conduct of business or served some other legitimate business purpose without substantially lessening competition.

1977 Report of the U. S. Department of Justice to the Task Group on Antitrust Immunities, at vii-viii.

Two years later, this refrain was echoed in even stronger terms by the National Commission for the Review of Antitrust Laws and Procedures which recommended that "The current broad immunity for the business of insurance granted by the McCarran-Ferguson Act should be repealed."[17]

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[17] Report to the President and the Attorney General of the National Commission for the Review of Antitrust Laws and Procedures, January 22, 1979 at p. 64. The Commission went on to recommend also that certain narrowly drawn legislation be adopted to affirm the lawfulness of limited number of essential collective activities under the antitrust laws.

Senator METZENBAUM. Thank you very much, Mr. Brown.

We will hear from Mr. Earl Pomeroy, accompanied by Mr. Campaniano.

STATEMENT OF EARL R. POMEROY

Mr. POMEROY. Mr. Chairman, good morning. Members of the committee, I am Earl Pomeroy, Vice President of the National Association of Insurance Commissioners, and Insurance Commissioner from North Dakota.

David Gates, Insurance Commissioner from Nevada, President of our Association, was going to present the testimony this morning. Unfortunately, he became ill en route from Carson City and I am filling in, along with Robin Campaniano, Commissioner from Hawaii, and Chairman of the NAIC committee on Personal Lines Coverages, Auto and Homeowners.

At the outset, Mr. Chairman, the NAIC acknowledges that the bill explicitly recognizes the primary role of the States in regulating insurance. We appreciate your support in this regard.

My testimony this morning will concentrate on two areas. First, I will detail the basis for the NAIC's opposition to the bill based upon the host of questions it raises relative to existing legitimate insurance industry activities and regulatory oversight.

Second, I will briefly inform you of NAIC activity presently underway which technically assesses and addresses the heart of antitrust concerns with the industry, the role of property/casualty rating organizations.

First of all, it is important to note that the application of the antitrust exemption contained in McCarran-Ferguson is not nearly as broad as some of the proponents of Senate bill 719 may contend.

A 1979 U.S. Supreme Court ruling in the *Royal Drug* case and other court rulings have increasingly narrowed the meaning of "business of insurance." It is highly unlikely egregious forms of market-splitting, price-fixing, or other horrors would be protected under the McCarran-Ferguson Act.

In addition, the Act specifically exempts actions which constitute boycott, intimidation or coercion. The action filed by General Brown and 18 other attorneys general reveals that allegations of antitrust activities in the insurance industry are indeed actionable under present law.

Nor is the insurance industry's status as to the antitrust laws unique. Labor organizations, professional sports, the maritime industry, and others also have specific exemptions relative to antitrust laws.

While Senate bill 719 includes language recognizing State regulation and focuses on the antitrust exemption, we believe that the adoption of this bill would have an adverse effect on State regulation.

We would like this committee to examine the McCarran Act not by considering the Act as if we were discussing creating an antitrust exemption de novo, but by considering the nearly half century experience of State regulators with the Act.

The business of insurance has been effectively regulated by the States for over 40 years under the existing statutory framework.

Regulators carry out their responsibilities with some certainty under the existing law.

If this bill is adopted, almost all State regulatory actions will have to be analyzed to determine whether a certain safe harbor may apply or whether protection from antitrust lawsuits may be had under the State action doctrine. We do not consider this to be an apology for collusive activities by the insurance industry.

We consider it our responsibility, Mr. Chairman, to point out that while your bill attempts to allow certain collective activities by insurers, these same activities will be jeopardized by Federal antitrust law enforcement or other law enforcement and investigation under the Federal Trade Commission Act.

The combination of insurers 'uncertainty as to the legal parameters within which they could safely operate on a coordinated basis, the severe penalties for an error in judgment, and the practical and costly problem of arriving at an informed decision promises a substantial lessening of insurer willingness to make available needed coverage, which cannot prudently be provided by a single insurer.

Furthermore, we believe that the insurers we regulate will use your legislation, if enacted, to evade State regulators by arguing that prior Federal approval is needed, or arguing absence of State authority because of Federal preemption, all to the disadvantage of insurance consumers.

Ironically, the consumers most impacted will be those most frustrated by the cost and availability of liability insurance coverages—family day care operators, nurse practitioners, small businesses, and others.

Also, under Senate bill 719, States face the possibility of the Federal Trade Commission and its staff telling our State legislators and State insurance departments how they ought to be doing their job.

We invite you to receive any recent FTC press release if you doubt this prediction. In a February 20 press release, the FTC indicates that they were informing legislators in Virginia how to pass bills relating to pre-need funeral plans, telling State legislators in Colorado what to do with branch banking, telling State legislators in Georgia how they ought to proceed with hospital certificate of need regulations, and telling State legislators in New York how they ought to proceed with State dairy regulation.

According to the press release, the views offered were from the FTC staff, not the FTC itself, whatever that means.

The confusion may be compounded because, as you know too well, FTC views, staff or otherwise, can change from one administration to the next; so can enforcement of antitrust law and promulgation of trade regulation rules.

This type of instability and uncertainty can only aggravate availability problems in the insurance market.

In addition, Mr. Chairman, the insurance commissioners have formed a committee investigating the role of ratemaking organizations. Well before ISO's announcement, this committee had taken the position that fully-developed ISO rates were no longer appropriate, and we are moving to the next stage of investigating the transition period necessary to bring insurance departments and small

companies formerly dependent on these rates into line with the new regulated format.

We have approached this from a very technical, thoroughly studied viewpoint, and that is the advantage of the State regulators dealing with this issue, Mr. Chairman, rather than the bill before us.

In concluding, we remind the committee that when the first debate over the McCarran Act took place at the time of enactment, it was the NAIC that took the lead in fashioning a compromise.

To the extent there have been competition-related problems in the insurance industry, we believe the boycott, coercion or intimidation phrase in the current McCarran Act gives the Federal and State governments sufficient access to antitrust tools. If it appears this authority is not sufficient, we would be among the first to step forward and urge that you add to this list of prohibitions under the current antitrust laws.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Pomeroy follows:]

TESTIMONY

OF THE

NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

BEFORE THE

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

Presented by Earl R. Pomeroy
Vice-President, NAIC and
Insurance Commissioner
State of North Dakota
Tuesday, April 18, 1988
Washington, D.C.

I. Introduction

Good Morning, Mr. Chairman and members of the Committee. I am Earl Pomeroy, Vice-President of the National Association of Insurance Commissioners (NAIC) and Commissioner of Insurance in the State of North Dakota. The NAIC is a non-profit organization made up of the chief insurance regulators in the 50 states, the District of Columbia and four United States territories.

David Gates, NAIC President and Nevada Insurance Commissioner had intended to present our testimony at this hearing. Unfortunately, he became ill en route from Carson City and is unable to be here this morning. Joining me at the table is Robin Campaniano, Commissioner of Insurance from the State of Hawaii, Chairman of the NAIC Committee on Property/Casualty Personal Lines Insurance.

The NAIC has testified before the Congress many times in opposition to proposals to amend the McCarran Act. When the proposals called for repeal of the entire McCarran Act, we tried to explain that the Act is more than an antitrust exemption for the business of insurance. It is an authorization by the Congress that the states should regulate and tax the business of insurance. We appreciate Senator Metzenbaum's support of state regulation as reflected in the very first declaration in S. 719 which states that "the continued regulation and taxation by the several states of the business of insurance is in the public interest."

We can understand that when a group of lawyers examines the

McCarran Act, they can see only an antitrust exemption which they prefer to have repealed. We cannot understand how anyone who examines the insurance industry concludes that the exemption has allowed the industry to fix prices, to engage in monopolistic practices or otherwise to restrain trade. Surely, there are problems within the insurance industry. But, for the most part, our experience has been that there has been too much, rather than too little, competition.

In fact, it has been awhile since the proposals to amend McCarran have called for a total repeal of the Act. Instead, all the recent proposals focus on the limited antitrust exemption for the business of insurance. Perhaps, I should stop here and emphasize that the exemption is a limited one. The Royal Drug case (Group Life & Health Insurance Co. v. Royal Drug, 440 U.S. 205 (1979)) is worth reading, or rereading, by anyone who is tempted to describe the exemption as a broad one. And, there are a host of statutes, in addition to case law, to recommend to anyone who is tempted to describe the exemption for the business of insurance as the only antitrust exemption.

While S. 719 includes language recognizing state regulation and focuses on the antitrust exemption, we believe that adoption of S. 719 would have an adverse effect on state regulation.

We would like this Committee to examine the McCarran Act, not by considering the Act as if we were discussing creating an antitrust exemption de novo, but by considering the nearly half-century experience of State regulators with the Act. During that

time, insurance has become more, not less, competitive.

II. S. 719: Safe harbors or Ports of Uncertainty?

The business of insurance has been effectively regulated by the states for over 40 years under the existing McCarran Act. The Act itself has been refined and the antitrust exemption narrowed by numerous court decisions since 1945. Regulators can carry out their responsibilities with some certainty under the existing law. If S. 719 is adopted, however, almost all state regulatory actions will have to be analyzed to determine whether a certain safe harbor may apply, or whether protection from antitrust lawsuits may be had under the state action doctrine.

We do not consider this an apology for collusive activities by the insurance industry. We consider it our responsibility to point out that while your Bill attempts to allow certain collective activities by insurers such as joint underwriting, pooling arrangements and market assistance programs, these same activities will be jeopardized by federal antitrust law enforcement or other law enforcement and investigation under the Federal Trade Commission Act. The combination of insurers' uncertainty as to the legal parameters within which they could safely operate on a coordinated basis, the severe penalties for an error in judgement, and the practical and costly problem of arriving at an informed decision promises a substantial lessening

of insurer willingness to make available needed coverage which cannot be prudently provided by a single insurer.

Furthermore, we believe that the insurers we regulate will use your legislation, if enacted, to evade state regulators by arguing that prior federal approval is needed or arguing absence of state authority because of federal preemption - all to the disadvantage of insurance consumers.

Ironically, the consumers most impacted will be those most frustrated by the cost and availability of liability insurance coverages: family day care operators, nurse practitioners, small businesses and others.

III. FTC to Direct State Regulation of Insurance?

Also, under S. 719, states face the possibility of the Federal Trade Commission and its staff telling our state legislators and state insurance departments how they ought to be doing their jobs. We invite you to review any recent FTC press release if you doubt this prediction.

According to a February 20, 1989 FTC press release, the FTC has been busy this year telling state legislators in Virginia how they ought to proceed with bills relating to pre-need funeral plans, telling state legislators in Colorado how they ought to proceed with bills on branch banking, and telling state legislators in Georgia how they ought to proceed with hospital

certificate of need regulations. According to a February 27 FTC press release, the FTC intervened, again, telling state legislators in Colorado how they ought to proceed with regulations for the credit repair industry, telling state legislators in Nebraska how they ought to proceed with hospital certificate of need regulation, and telling state legislators in New York how they ought to proceed with state dairy regulations.

According to the press release, the views offered were from the FTC staff and not the FTC itself, whatever that means. The confusion may be compounded because, as you know too well, FTC views, staff or otherwise, can change from one Administration to the next. So can enforcement of antitrust law and promulgation of trade regulation rules. This type of instability and uncertainty can only aggravate availability problems in the insurance market.

Mr. Chairman, as a state regulator I can point to other areas of Federal activity which have resulted in unanticipated problems in the insurance marketplace and insurance regulation.

ERISA has deprived those covered by employer sponsored self insured health plans access to the complaint resolution functions of state insurance departments. Consumers who do not get their claims paid have nowhere to go.

The Risk Retention Act sought to address liability insurance availability difficulties but has left in its wake insurance entities of questionable solvency and restricted the

ability of state insurance departments to assert the solvency protections which apply to the rest of the conventional insurance marketplace.

We believe there would be a variety of issues raised by the passage of S. 719 which would ultimately disrupt the marketplace and disturb the existing regulatory framework for the regulation of insurance.

It is this type of interference from the federal government that we believe could set the stage for the dismantling of state regulation.

IV. NAIC Recommendations Regarding Rate-Making

While we have opposed efforts to amend McCarran's antitrust exemption, we are mindful that many interest groups and some members of Congress have concluded that transmission of advisory rates is the equivalent of price-fixing, which should be prohibited through repeal of the limited antitrust exemption in the McCarran Act.

Insurers consider their own experience, the competitive market, the advisory rates and other data, and then select their own prices for their insurance products, except where the state regulator establishes the price. Furthermore, the trend in states has been away from the dissemination of advisory rates as provided by the NAIC Model Legislation with respect to

competitive rating for liability insurance. (NAIC 1983 Property and Liability Model Alternative Competitive Pricing and Appropriate Support Systems Act, Section 12, NAIC Model Laws, Regulations and Guidelines.)

At the same time, we recognize that there is the potential for anticompetitive effects in connection with development of final advisory rates and we have been mindful of that potential in reexamining the role of property-casualty advisory organizations. It has been our experience that in liability insurance coverages, insurers do not adopt the advisory rates.

In December 1988, the NAIC established a special working group to evaluate the appropriate role of rate-making organizations in property-casualty insurance. The working group is made up of seven members including myself; all are insurance regulators. We have held three hearings around the country, heard extensive testimony, and have focused our discussion on the preparation, filing, and distribution of fully developed advisory rates.

The position of the NAIC and the individual states on advisory or rate-making organizations has evolved as has the nature of the insurance marketplace and its regulation. In the past, advisory organizations' final gross rates were viewed as one element in protecting an insurance company's solvency, while at the same time enabling many smaller companies to compete in markets they otherwise would not have been sophisticated enough to address. Over time, however, greater reliance has been placed

on price competition among insurers and less reliance on advisory rates.

The model competitive rating laws developed by the NAIC in the early 1980's prohibited the preparation and filing or distribution of final advisory rates. Several states have enacted such prohibitions, and other states are currently contemplating such action.

The NAIC is now revisiting the issue of collective activities for several reasons. One is the need to determine whether the prohibitions contained in the current competitive rating models should be modified to reflect current development in technology and the capabilities of individual insurers in preparing their own rates. A second reason is the need to examine whether restrictions on advisory rates should now be extended to the NAIC model law for prior approval rate regulation. Finally, a third reason is the need to identify what other ways the NAIC can assist states in moving to a loss cost only environment. A number of difficult technical questions have to be resolved in addressing these broader issues. The paramount objective is to obtain the best possible outcome for consumers.

On the one hand, it is fairly clear that some sharing of information among insurers offers certain efficiencies which benefit consumers; on the other, the efficiencies gained from allowing insurers to share final rates may be offset by its potential for inhibiting competition. Determining where the optimal balance lies between these two extremes in various

regulatory and market environments is the primary task faced by this NAIC working group.

Following a hearing on these issues in Chicago on March 3, the NAIC Working Group adopted a resolution (Attachment A) stating that with respect to property-casualty lines of insurance:

- advisory organizations should not be allowed to file or distribute final rates that contain provisions for expenses and profits and that this principle should apply whether the regulatory environment is "competitive" or "prior-approval";
- advisory organizations should be confined to the collection, compilation and distribution of loss costs; and
- insurers should individually prepare and file their own rates where filing is required.

In other words, the NAIC Working Group believes that insurance companies can use rates based on common loss data compiled by advisory organizations, but each insurer must apply its own expense and profit factors to this data to produce its rates. We will address workers compensation insurance rate-making later this year.

The NAIC held a second hearing on rate-making in Little Rock, Arkansas on March 20. At that hearing, we addressed a number of other technical areas, with the focus being on the

ability of the various states to implement and manage rate filings in this new environment. Some of the technical areas include loss development and trending, loss adjustment expense, supplementary rating information, rating factors or relativities, and the transition to a loss cost system.

For example, we received testimony from the Virginia insurance department. They recently reviewed their rate filing system and proposed that advisory organizations be allowed to collect and distribute certain loss data including both allocated and unallocated loss adjustment expense, but that each insurer should add its own profit and contingency loading and file its own final rates. The Virginia department found it critical to allow advisory organizations to continue to file standard policy forms and manuals of rules on behalf of insurers.

Also, the Virginia department advised that the states must address various issues in reviewing their filing and permissible activities by advisory organizations. For example, in rating, there are important differences in personal, as opposed to, commercial lines of insurance. Personal lines of insurance consist of more homogeneous risks. There are fewer classes relative to the several thousands of classes found in commercial lines where the risks are heterogeneous. And, there is much more variety in the types of coverages which further complicates the filing issue. In personal lines of insurance, the manual rate is often the final rate but in commercial lines of insurance the manual rate is the starting point in figuring the final rate.

Insurers that have relied on advisory organizations to file their rates will have to build upon the developed and trended loss information in order to create their rate filing. More importantly, states need to assess the impact of individual filings on state departments. In Virginia, the Insurance Services Office made 48 filings in 1988. If every licensed company filed for each line, there would be over 11,000 filings. But the impact is not as dramatic as these numbers indicate because it is anticipated that companies will only file if they will compete in that market.

We held a third hearing on the rate-making issue in Washington, D.C. on April 4. We solicited your views as well as a number of consumer groups, professional groups, and small business people. Some said that it was not enough to prevent rating organizations from filing profit and expense factors. Others, for example, insurance agents, thought that there would be additional costs when final rate manuals are no longer provided by the Insurance Services Office. But most who testified said that they could adapt to a system of no final rates, eventually.

We have provided the Committee with a complete record of the materials that the NAIC working group has compiled. We invite you to study the record and provide comments. The working group will continue to explore whether in addition to prohibiting advisory organizations from filing and distributing final rates containing provisions for expenses and profits, we should

recommend further restrictions to the states relating to rate-making.

The point in our explaining the process the NAIC has gone through is to demonstrate that we have the expertise to examine, in depth, the services offered by advisory organizations and make the appropriate recommendations to the states after having weighed any anti-competitive effects against efficiencies created. We believe this approach is preferable to amending the McCarran Act, at this time.

V. Conclusion

In concluding, we remind the Committee that when the first debate over the McCarran Act took place, the NAIC took the lead in fashioning a compromise. To the extent that there have been competition-related problems in the insurance industry, we believe the "boycott coercion or intimidation" phrase in the current McCarran Act gives the federal and state governments sufficient access to antitrust law enforcement tools. If it appears that this authority is not sufficient, we would be among the first to step forward and urge that you add to this list of prohibitions under antitrust law. For now, we urge that you allow us to recommend to the states that each state initiate the changes in the rate-making process we described.

Lastly, while we are on the subject of law enforcement

tools, we respectfully recommend that when this Committee considers proposals to amend the Racketeer Influenced and Corrupt Organizations Act ("RICO") that the state insurance regulators be among those government entities who may still recover automatic treble damages when the facts show that insurance fraud has been perpetrated upon policyholders. The federal RICO statute has been one of the more effective law enforcement tools for state regulators to use in our fight against insurance fraud. We would appreciate an opportunity to elaborate on this when you hold hearings on your RICO Bill in June.

THANK YOU

RESOLUTION

Advisory Organization Activities Working Group
Chicago, Illinois
March 3, 1989

WHEREAS, at its December 1988 meetings in New Orleans, the National Association of Insurance Commissioners (NAIC) established the Advisory Organization Activities Working Group to examine the appropriate role of advisory or rate-making organizations in property-casualty insurance, particularly with respect to the filing or distribution of "fully developed" rates; and

WHEREAS, the working group has since discussed these issues in meetings in Washington, D.C. and Denver and received testimony from various parties at a public hearing in Chicago on March 3; and

WHEREAS, the working group also has received staff presentations on advisory organization activities and the rate-making process; and

WHEREAS, the NAIC's alternative competitive rating model laws currently prohibit advisory organizations from distributing final rates which include provisions for expenses and profits; and that, under these acts, advisory organizations are confined to the collection, compilation and distribution of prospective loss costs (including loss adjustment expense) which can be adjusted for development and trending; and

WHEREAS, among the major issues before the working group is the question of whether these provisions should be modified and extended to the NAIC's model prior approval rating law; and

WHEREAS, after careful consideration of the issues in light of the testimony received, the working group has reached some general conclusions about the appropriate role of advisory organizations in the rate-making process in property-casualty lines other than workers' compensation, which, because of its unique characteristics, the working group has elected to address separately.

NOW THEREFORE, BE IT RESOLVED, with respect to all other lines of property-casualty insurance, the working group believes that: (1) advisory organizations should not be allowed to file or distribute final rates that contain provisions for expenses and profits and that this general principle should apply to all regulatory environments; (2) advisory organizations should be confined to the collection, compilation and distribution of loss costs; and (3) insurers should individually prepare and file their own rates where filing is required and that these rates can be based on common loss data compiled by advisory organizations; but each insurer must apply its own expense and profit factors to these data to produce its rates.

NOW THEREFORE, BE IT FURTHER RESOLVED, that the next objective of the working group will be to formulate detailed recommendations as to the application of these general principles to the various property-casualty lines in different regulatory environments; a number of technical areas will be addressed, including loss development and trending, loss adjustment expense, supplementary rating information, rating factors or relativities, and the transition to a loss cost system; and that hearings will be held in Little Rock and Washington D.C. to explore these areas in greater depth.

Senator METZENBAUM. Thank you very much, Mr. Pomeroy, and thank you, Mr. Campaniano, for making the long trip to be with us here. We appreciate your participation.

The Chair will institute a 5-minute time limit for the first round of questions by each member of the committee, including myself, of course.

Mr. Brown, can you give us an update on the attorneys general antitrust suit, to the extent that information is public?

Mr. BROWN. Yes, I can, Mr. Chairman. The suit was filed, of course, in the spring of 1988. Motions to dismiss were filed by the many defendants in December of 1988. I might add that the room, when the first motions were filed, had a number of State attorney general representatives, and then dozens of insurance company defense lawyers.

There were so many in the room that the Federal judge said this looks like an immigration proceeding rather than a trial coming up.

On July 7, after this month's rounds of responses to the motions filed in December—on July 7 will be the hearing before the court dealing with all the preliminary legal issues. The judge wants to dispose of the legal issues first before we do the discovery on the factual issues.

Senator METZENBAUM. Has McCarran-Ferguson presented any particular problems for you in prosecuting that case?

Mr. BROWN. Not the boycott area, because we feel that what they did was covered by the boycott. We were not able to explore the issue of price-fixing; that is, that was a verboten subject for us to file suit on because price-fixing is legal.

If the laws pertaining to price-fixing were repealed, as has been proposed by members of this committee, then a broader arsenal of enforcement could be done by the State attorneys general and the U.S. Department of Justice.

Senator METZENBAUM. In your opinion, would Federal enforcement of the antitrust laws interfere with State enforcement?

Mr. BROWN. Oh, no. We have had a very good, cooperative relationship in most cases over the decades between Republican and Democratic administrations. Our State attorneys general operate on a very bipartisan and nonpartisan arrangement. The Attorney General of Wisconsin and I sit together and have worked together on a number of things, like a case involving Chrysler where we were involved in a similar matter in West Virginia.

I think that it is a very cooperative relationship, and would continue to be if this bill were passed.

Senator METZENBAUM. Mr. Pomeroy, tell us the specific regulatory activities you believe would be hampered if McCarran were modified.

Mr. POMEROY. Mr. Chairman, I think there would be a range of issues up in the air as to whether the FTC would take action preempting State regulators or whether it would be, in fact, within the role and province of a State insurance department.

We commonly see, Mr. Chairman, arguments thrown at us as to areas, for example, under the Risk Retention Act recently enacted. Those interests subject to our regulation are quick to throw up the screen of Federal preemption as an area not for State regulation.

We think it would make our job a great deal more difficult due to the uncertainties that would be created.

Senator METZENBAUM. Well, Mr. Pomeroy, as I have stated before, if there are special problems, we are prepared to work with the insurance commissioners or the insurance companies, or anyone else, to fashion language so that there won't be any possibility of a problem.

The attorneys general say they don't see that it would create any problems. You say that it would. We are ready to provide clarification, if that is what is needed. What concerns us, frankly, is that the insurance commissioners, some of whom do a superb job, some of whom do a reasonable job, and some of whom don't do too well at all—it does concern us that the argument is made that the repeal of a law that applies to every other industry in America is going to somehow interfere with your activities, and I just have difficulty following that.

Mr. POMEROY. Mr. Chairman, first of all, there is a level of concerted activity which is required to get an actuarial basis for the promulgation of rates. As Senator Kohl very aptly pointed out in his opening statement, the price is set before the costs are known, and you are going to drive small and mid-sized companies out of the market if you don't allow the joint rate-setting activities.

You allow some of them in the bill. It is clear under the bill that prospective loss development, including trending, would not be allowed. I am on the insurance commissioners 'committee investigating what is permissible by way of joint ratemaking activities. We have not been able to technically conclude, Mr. Chairman, that this wouldn't have a very real impact on the ability of many of the players in today's marketplace to participate.

We think a better approach than the bill before us—if there are specific areas of insurance industry activity that are contrary to the public interest. We think that you should consider, rather than scrapping the existing environment and adding back safe harbors, looking at the prohibitions existing—intimidation, coercion, and boycott—and adding to them, if you can articulate particular, egregious problems that are presently being committed.

Senator METZENBAUM. Thank you, Mr. Pomeroy.

Senator Thurmond.

Senator THURMOND. Thank you very much.

Mr. Pomeroy, you are the State Insurance Commissioner of North Dakota?

Mr. POMEROY. That is correct.

Senator THURMOND. Are you appearing here as an individual in that capacity or are you representing the insurance commissioners of the Nation?

Mr. POMEROY. I am speaking, Mr. Chairman, as vice president of our national association. I am also speaking as the commissioner of North Dakota.

Senator THURMOND. Do the State insurance commissioners of the Nation favor this bill or are they against it?

Mr. POMEROY. They are against it.

Senator THURMOND. They are against this bill, the State insurance commissioners throughout the Nation?

Mr. POMEROY. Yes.

Senator THURMOND. Mr. Brown, we are glad to see you again.

Mr. BROWN. Nice to see you, Senator Thurmond.

Senator THURMOND. Whether we are on the same side or not.

Mr. BROWN. We have been on beer antitrust issues and a number of things, and I am very honored to be before you.

Senator THURMOND. We are glad to have you here, and you are a very articulate spokesman for your position, too. Would you comment on the recent changes adopted by ISO and give us your opinion about those?

Mr. BROWN. Well, as I read it—and I must say it was only brought to my attention by my staff this morning in the material I carried to Washington, so I must say I am not very familiar with it.

I do think it is a big step forward and I am very pleased to see ISO do this, and my feeling is that they would probably be, therefore, not so opposed to what we are trying to do here and what Senator Metzenbaum wants to do. Since they have decided not to have advisory rates, let us just deep-six advisory rates forever by passing legislation.

Mr. POMEROY. Senator Thurmond, if I might comment briefly on the ISO position, prior to their taking that step, State regulators, through the committee studying the issue, had concluded that fully-developed advisory rates were no longer appropriate and were taking steps to prohibit it.

There will be legislation, I am confident, enacted in the States addressing fully-developing rates. There will not be any going back toward fully-developed rates, as General Brown suggested in his earlier answer, once the heat is off.

Senator THURMOND. Mr. Campaniano, you are from way out there in Hawaii.

Mr. CAMPANIANO. Yes, sir.

Senator THURMOND. Tell us, frankly, how you feel about this bill.

Senator METZENBAUM. And would you be willing to have our next committee meeting in Hawaii? [Laughter.]

Mr. CAMPANIANO. We would be very glad to host you there to show you the unique problems of insurance regulation amongst the several States, especially in Hawaii.

Senator, you had asked me what my feelings were relative to the proposed changes. I must feel as a State regulator that it portends an atmosphere of doubt. It will create an aura of suspicion over any activity which we may enter into and which the insurance industry may enter into.

It would inhibit regulators like myself from taking action within my own jurisdiction relative to working out certain problems I may have with the insurance industry. For small States like Hawaii, it is very easy for me to approach the industry in a collective manner and ask for their assistance in providing coverage for a day care center, and asking them for assistance in providing insurance in a line like nursing homes.

I am very much concerned, Mr. Chairman, that if this legislation goes forward, such activity will fall through the cracks and that there will be great anticipation and concern by members of the industry that such activity will no longer be permitted. It is this type

of informal activity which allows us great latitude in trying to meet the needs of consumers within our own jurisdictions.

Senator THURMOND. I wanted to ask both of you commissioners—now, as I understand it, you are both against this bill; that is your personal feeling and that of the commissioners as a whole.

What we have got to do is do what is in the best interests of consumers. I think that is our main job, to protect the people of America. Do you really feel that to oppose this bill is in the best interests of the public?

Mr. POMEROY. Mr. Chairman, I would like to speak to that. I am an elected insurance commissioner. Recently, I was reelected this past fall by nearly 70 percent of the voters in my State, and I believe it was because I have taken a very active record for tough consumer protection for insurance consumers. I do not believe this bill is in the interests of insurance consumers of North Dakota or the country.

Senator THURMOND. Is that your position, too, Mr. Campaniano?

Mr. CAMPANIANO. Yes, sir.

Senator THURMOND. Thank you very much.

Senator METZENBAUM. Senator Kohl.

Senator KOHL. Mr. Brown, you have said several times flat out that what happens here is that insurance companies get together and establish rates, and thereby drive up prices. That is a flat-out statement?

Mr. BROWN. Yes, sir.

Senator KOHL. And what you want to undo is that practice?

Mr. BROWN. Yes, I do.

Senator KOHL. OK. Mr. Pomeroy, you disagree entirely with that statement?

Mr. POMEROY. Yes, we do, Senator.

Senator KOHL. You are saying that insurance companies do not get together and set rates?

Mr. POMEROY. There is joint—rating organizations compile loss data——

Senator KOHL. Yes, I understand that.

Mr. POMEROY [continuing]. Develop the loss data, trend the loss data.

Senator KOHL. Yes, but you don't deny that they have the right to get together and set rates, which is what Mr. Brown says? They have the right to do it and he says, of course, they have the right to do it and they do do it. You are saying that they have the right to do it, but they don't do it?

Mr. POMEROY. Senator, I am saying they do not do it. I am in my fifth year as an insurance regulator. I do not see the companies in my jurisdiction or other jurisdictions getting together and setting rates.

The rating organizations, operating as the statistical agent for a State jurisdiction, will compile the experience of a number of companies to obtain the actuarial basis necessary for a company to establish its own rates, but then we find a very competitive rating situation.

In fact, we have had situations where it has been so competitive that premiums have not been adequate to cover the losses, what is known as a soft market, resulting in an inevitable reversal of that

with drastically reduced capacity and availability and much more expensive premiums.

Now, we think that is an indication that, in fact, there is plenty of competition. In a soft market, it might be argued there is too much competition.

Senator KOHL. But why wouldn't you want to remove their right, which you say they don't exercise anyhow, to get together and establish rates? If you are saying they don't do it—and I presume you would agree that they shouldn't—what is wrong with legally eliminating their right to do it?

Mr. POMEROY. The bill before us would impact the information that the small companies in Wisconsin and the rest of the country would be able to obtain through a rating organization. That would directly impact their ability to enter the marketplace and make a market available, particularly perhaps a niche market where coverage is difficult to obtain or very expensive in the first place.

Senator KOHL. I understand what Mr. Brown is saying in a most precise and clear way, but I think that your answers are not quite as clear.

Mr. Brown, I would like to ask you a question. I am concerned about instances in which insurers have attempted to pull out of particular markets. For example, after West Virginia passed an insurance reform proposal in 1986, five of the largest medical malpractice insurers in the State immediately canceled coverage for doctors and other health professionals. They refused to write new policies until the West Virginia Legislature rewrote the law.

My question is, if the Federal antitrust laws applied to the business of insurance, would these insurance companies have been able to attempt mass cancellations in West Virginia?

Mr. BROWN. The answer, Senator Kohl, is they would not be allowed to do mass cancellations if the Federal laws applied to them. We believe that the Federal boycott law, though, would have applied to that situation. However, the Justice Department and the FTC declined to assist us.

I filed our own antitrust case under State law, and the State antitrust act was sufficient to get an injunction against the insurance companies, pending subsequent legislative action. So we feel that behavior amounted to either a boycott or a similar concerted refusal to deal.

Senator KOHL. Do you know of any other instances where insurance companies have threatened to pull out of particular markets?

Mr. BROWN. There have been a number of threats. There has been a lot of discussion in California after 103 passed. There have been discussions in Florida. The one time we know of where they actually pulled out and gave notice was in my home State, and the consequences would have been catastrophic to the delivery of health care and to the lives, actually, of our citizens—no ambulance services, and so on. And

I think that type of irresponsibility has led directly to scrutiny by the Congress.

Senator KOHL. Thank you. Thank you, Senator.

Senator METZENBAUM. Thank you, Senator Kohl.

Senator Hatch.

Senator HATCH. Of course, the point that should be made is that you were able, within the laws of your State, to correct that.

Mr. BROWN. Yes, I was, Senator Hatch.

Senator HATCH. Well, it is true, is it not, that most States have antitrust laws that permit the State attorneys general to challenge alleged anticompetitive activity within that State's borders?

Mr. BROWN. I think the majority of State legislatures, Senator Hatch, have chosen to exempt insurance, as has the Federal Government. New York exempts it; Ohio does. California did until Proposition 103. But our State is one of those that does not exempt insurance.

Senator HATCH. And a number of others do not.

Mr. BROWN. That is right; a number of others do not.

Senator HATCH. But the State can change that if it wants to do so.

Mr. BROWN. That is right.

Senator HATCH. In other words, each State has it solely within its power to change their laws, if they have an exemption, to refuse to grant the exemption. And, of course, those States that don't have exemptions have every right and power to bring legal action to correct any anticompetitive practices, States like yours.

Mr. BROWN. Well, the Federal judge in the case we had when the companies removed said that the issue of boycott was exclusively a Federal remedy and was not a State remedy that would be allowed under our antitrust act.

Senator HATCH. But you have to admit there is still a question whether the boycott statute would have applied in that particular instance.

Mr. BROWN. Yes.

Senator HATCH. You felt it would, but there are others who felt it wouldn't, including those at the Justice Department.

Mr. BROWN. That is correct, Senator Hatch. I don't really know why Justice didn't act. They cited a study by the Federal Trade Commission that insurance was competitive, and I think there are a lot of Federal agencies that rely too much on studies and not enough on behavior. Therefore, they declined to act.

Senator HATCH. Well, I think the question I have, basically, is why is not the power the States presently have, especially in your case, in your State, or in any other State, for that matter—why is that not sufficient to resolve any problems that might result from anticompetitive conduct?

Mr. BROWN. Well, Senator Hatch——

Senator HATCH. I presume if the States wanted to pass antiboycott laws, they might be able to do that, too.

Mr. BROWN. Yes. That is a very good question, Senator Hatch, and I think the boycott area is one that the States and the Federal Government can both act on together. But when it comes to national and international price-fixing, the States simply are not very well equipped to act.

If we have the legal authority to act against price-fixing by insurance companies—and I think that may be an open question, given the McCarran-Ferguson Act and whether that preempts the States from moving. I don't know if that question has been answered. It might have been; it might not have been.

But even if it has, the Justice Department has the national subpoena power; they have a criminal statute. They are the ones who really can go after the major price-fixing cartels. The States are kind of a bow-and-arrow approach. In terms of our resources, usually we may have two or three or four lawyers, sometimes no lawyers in many States, to do antitrust enforcement.

Justice, with its hundreds of lawyers, national subpoena power, and grand juries that encompass multistate and international efforts—we just can't compete with that degree of resources, and we are glad they have those resources.

Senator HATCH. Are you asserting here today that there are anticompetitive cartels in the insurance industry in this country?

Mr. BROWN. Yes, I am, Senator Hatch. I think the fact that there were advisory rates up until just recently indicates that the industry was, in fact—I would call advisory rates a price-fixing cartel.

Senator HATCH. There is a whole other side to that issue, as you know.

Mr. BROWN. Well, I would believe so, but I think most economists would say that an advisory rate by an industry is a measure of cartel behavior.

Senator HATCH. If there are anticompetitive results that occur from that, and there is a real question whether there are any anticompetitive results. Like I say, the antitrust commission that I was on found that there were not, and I don't know anybody who argues that there are anticompetitive results.

So, you know, it is one thing to say I don't agree with advisory rate-setting groups. I mean, that is a legitimate position. But to say I don't agree with them even though they don't result in anticompetitive conduct or activity—it seems to me, that is another matter.

Plus, you have insurance commissioners, you have got State attorneys general with all the power in the world to resolve any difficulties that do arise. The system has worked very, very well.

Now, if we take your point of view, we bring in the whole almighty Federal Government, the Justice Department, and everybody affiliated with it, with accompanying rules and regulations and maybe different interpretations of the antitrust laws, depending upon which party is in power in the executive branch.

We wind up having a big mess here that really abuses the consumers by having the insurance costs start to escalate beyond belief. This is what really drives this matter, in the eyes of many of us who personally do not feel that Federal preemption in these fields is always the answer or that Federal laws are always the answer, or that when States are operating effectively and well in all 50 States and where we have the most competitive industry in our whole society operating in the most competitive way, that we all of a sudden, with something that isn't broken at all, ought to suddenly step in and fix it and apply the almighty Federal Government, with all of its onerous burdens that occur that escalate costs for the consumers.

That is why I have a rough time understanding why the State attorneys general are constantly for more Federal Government approaches here. You fellows ought to be arguing for your rights to operate the way you do, and you ought to be, it seems to me, in-

stead of testifying—I am not criticizing you for testifying; you have been articulate.

But instead of testifying so much, you guys ought to be out there enforcing these laws if there is anticompetitive conduct, and maybe we ought to have less politics and a little more action within the States. I think sometimes that is the criticism I have of the State attorneys general.

They have been in here for every major liberal program in America time after time, from *Illinois Brick* to this one. Why don't you enforce the laws that you can enforce in your own States, with all the rights and powers that you need?

I disagree with you. I think you have a pretty broad subpoena power and you can do an awful lot of very effective, creative things to make sure that your consumers are not abused, and you don't need the almighty Federal Government to make it otherwise.

My time is up, I understand, but that is what bothers me. Year after year, the AGs come in here and they ask for all these new Federal rules, these new Federal approaches, and they have the power to do these things themselves.

You have power. You have State commissioners; you have State authority. That is the thing that bothers me.

Now, you can make any comments you would like, but that is my view.

Senator METZENBAUM. You may respond very briefly, Mr. Brown.

Mr. BROWN. OK. Thank you, Senator Hatch. We have probably been more active than we have ever been, I think national publications are indicating, not active in legislation, but more active in law enforcement in consumer protection and antitrust than at any point in the history of the office that we hold. I am very proud of that from both sides of the aisle around the country.

We need the Federal Government to help with our biggest problems. I mean, this is a $400 billion industry and to say that——

Senator HATCH. Tell me where the problem is. I don't see any problem.

Mr. BROWN. Well, okay. Very briefly, when bad times hit other industries, in recessions in cars or steel or any other industry——

Senator HATCH. Let us talk about the insurance industry.

Mr. BROWN. Well, okay. During their recessionary times, the advisory rates kept the prices up. In fact, the prices went through the ceiling. So under the insurance cycle, the insurance industry didn't have to suffer the financial shortfall that other industries suffered during their cycles.

Every industry has cycles, but the insurance industry believes, in their cycles, they will simply be able to have advisory rates to cushion the fall and make sure that they either don't lose money or don't lose it like another industry would.

Senator HATCH. That is not true.

Senator METZENBAUM. I would like to give Senator Simpson an opportunity to ask his questions.

Senator SIMPSON. Thank you, Howard; you are courteous.

I see Mr. Pomeroy shaking his head. Would you respond to that answer he just gave, please?

Mr. POMEROY. Thank you, Senator. I think there is a real misunderstanding about the use of fully-developed advisory rates in the

insurance industry. We see property/casualty companies deviating off of those rates substantially, and certainly no uniform applications of the fully-developed advisory rates in the prices ultimately charged by the property/casualty insurers.

In addition, my colleague, Commissioner Campaniano, has done an evaluation of sources of competition in the Hawaiian auto market. I would like him to briefly——

Senator SIMPSON. Well, we have a roll call vote, so if you can do that in about 30 seconds, fine, but I have a couple of questions.

Mr. CAMPANIANO. Senator, we found that there is virtually a unanimous conclusion of studies done by both State and Federal Governments, by NAIC, and by academic sources that the property and casualty industry in America is structurally competitive; that is, in reviewing the size and number of firms, in reviewing the concentration ratios of the insurers by line and by State, by applying the Department of Justice's merger guidelines through the Herfindahl-Hirschman Index and by reviewing the entry and exit of firms and the ease of entry and exit of firms into the market, we believe that the market is structurally competitive.

Moreover, I would like to add that the profits, as measured by the rate of return on net worth, for the insurance industry appear to be comparable to the average for other industries.

In other words, if the industry is making excessive profits or if the industry is making economic profits, it does not appear to be substantiated by the data available to me.

Senator SIMPSON. I thank you. It is a consistent and returning theme here as to what we should do with McCarran-Ferguson, obviously. But, to General Brown, you state that the McCarran-Ferguson exemption allows price-fixing, in a sense, by insurance companies, and then you have that report and then I have my own view.

How do you explain, then, the existence of the thousands of companies with a broad range of premiums? We have over 3,500 companies engaged in property-casualty insurance alone. How does that occur with what you are saying?

Mr. BROWN. When you don't have much price competition, it probably allows everybody to stay in. If the prices are artificially high—and who would want to fix prices low? I mean, if you are going to fix prices, you might as well fix them high, higher than the market would allow.

Then there isn't the price competition that you would expect, which means that small companies will rise to the top. The small companies stay small, the big companies stay big, and there isn't much changing ratios of market shares.

Senator SIMPSON. Now, you represent the State AGs, who support Senator Metzenbaum's bill, and Mr. Pomeroy represents State insurance commissioners, who oppose the bill. It sounds a bit like the attorneys general are making a little bit of a power grab there, perhaps, on the insurance commissioners. You want to control insurance through litigation.

I have been privileged to serve with former attorneys general in this body, Democrat and Republican alike. It is a great stepping stone to the Congress or to the U.S. Senate, I have found; at least I know several of them.

I still think that the State commissioners are better suited for this type of thing through regulation rather than this business of control through litigation under the auspices of the attorney general. What is your response to that?

Mr. BROWN. Senator Simpson, there are a lot of industries that are regulated on the State level, and we need insurance to be regulated on the State level for market abuses and taking advantage of consumers when they are ripped off.

It is not inconsistent to have antitrust enforcement, and where a specific State exemption exists where the States are regulating, then you give them that exemption. That is true in agriculture; it is true in industry after industry around America—utilities, and so on.

The regulation is the narrow exemption to the general law of competition. There is no problem with that. There is no other industry, though, that says we will give this blanket exemption for price-fixing.

Senator SIMPSON. Well, you know, it is fascinating stuff.

Mr. BROWN. It is.

Senator SIMPSON. I have been around here 10 years. The insurance industry is regulated. There are many other industries that have partial antitrust exemptions which make good sense. Some of those industries are organized labor, agricultural cooperatives, professional sporting teams, and the like.

You say that our current system under McCarran-Ferguson has stifled competition among the insurance industry and——

Mr. BROWN. Well, I don't think Commissioner Pete Rozelle has gotten the New York Giants and the New York Jets together and said why don't you fix the prices of your tickets so you won't have to compete with each other on a Sunday afternoon.

Senator SIMPSON. I didn't come here to hear about Pete Rozelle.

Mr. BROWN. OK, I am sorry.

Senator SIMPSON. I would like to hear about this, because I think a lot of this stuff goes with emotion.

Mr. BROWN. Sure.

Senator SIMPSON. That is fun, but I like to get into issues and use fact. In my experience in this place in 10 years—and I have said it hundreds of times—you either pass or kill a bill around here by the use of emotion, fear, guilt or racism. I prefer to wade those things in their own trough and extricate them from legislation.

Now, it seems to me there is a lot of hype in this thing. That is what I am saying. It seems to me, too, that I see a lot of just good, old populist politics in it, too. That is good, too.

Yet, interestingly enough, this gentleman has been reelected with 70 percent of the vote and he is known as a consumer-oriented person. You are obviously off on some populist consumer-oriented thing; that is for sure.

So it is interesting who is right, and I guess that is for us to scratch around in it and try to figure out who is, and we will. But it will be difficult because, again, we will be confronted with all the elements of politics that go with that, trying to figure out what is in the best interests of the industry.

Who among us is just interested in just seeing an industry pack its pocket with money from the poor, old citizens and giving them

nothing? The issues of tort reform and, you know, the issues of all of those things are tough, and tax reform, the insurance industry.

But that is our job, and I appreciate that.

The chairman has asked me to announce that there will be a 10-minute recess. We have a roll call vote and we will take up after that. I thank you very much.

Mr. BROWN. Thank you.

[Recess.]

Senator METZENBAUM. The second panel consists of Robert Hunter, National Insurance Consumer Organization, of Washington; James Serota, American Bar Association, accompanied by Harvey Perlman, Dean of the University of Nebraska Law School; and Stephen Brobeck, executive director of the Consumer Federation of America, of Washington.

Mr. Hunter, I understand you have to catch a plane, and for that reason I am going to put you on first. You know our rules about 5-minute testimony.

STATEMENT OF A PANEL CONSISTING OF J. ROBERT HUNTER, PRESIDENT, NATIONAL INSURANCE CONSUMER ORGANIZATION, WASHINGTON, DC; JAMES I. SEROTA, CHAIR, INSURANCE INDUSTRY COMMITTEE, ANTITRUST LAW SECTION, AMERICAN BAR ASSOCIATION, NEW YORK, NY, ACCOMPANIED BY HARVEY PERLMAN, DEAN, UNIVERSITY OF NEBRASKA SCHOOL OF LAW; AND STEPHEN BROBECK, EXECUTIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA, WASHINGTON, DC

Mr. HUNTER. Thank you, Mr. Chairman.

The insurance cartel is ripe for busting. I am going to say that and I am going to say who else said that. It was Business Week Magazine, April 11, 1988. "A smoke-filled room," quoting Business Week, "in which competitors set prices and carve markets is the setting often associated with violators of the antitrust laws, unless, that is, the competitors belong to the $350 billion U.S. insurance industry." "They routinely set prices," says Business Week. "The sooner Congress acts to end the cartel, the better off we will all be," concludes Business Week.

The Journal of Commerce, not exactly the Village Voice, said that we should end the McCarran-Ferguson Act. "Insurance companies have enjoyed for too long," they said, "the protection of an antitrust exemption that permits price discussion without fear of prosecution. This immunity keeps rates artificially high, impedes competition and, industry claims to the contrary, is not essential to collect the data insurers need to chart a successful business course."

"Competition of insurance, as this newspaper's extensive daily coverage of the industry confirms, works to the benefit not only of buyers of insurance, but to the better managed insurers as well. Eliminating antitrust immunity is an important step in increasing competition."

I think it is the better managed insurers who would benefit if your bill passed, and NICO is happy to endorse your bill today, sir. There is tremendous inefficiency in this insurance industry, in part

because of the McCarran-Ferguson Act, in part because of other acts at the State level that also do anticompetitive things.

But the McCarran-Ferguson Act is the key Act that keeps this industry noncompetitive and fat. Remember the cartoons from the trust-busting days of Teddy Roosevelt when the fat guys with the vests and the cigars had the money all hanging out of their pockets? That is kind of the picture of the cartel.

That is not exactly right for some parts of this industry, but the National Council on Compensation Insurance still fits that mold. If you look at Exhibit 4 of my testimony, their constitution requires adherence to their rates. "Each member shall adhere to all filings made by us." They must adhere unless States prohibit it.

The ISO has just made some moves. That is good, but if you look at what the Journal of Commerce has said about that, they say "too little, too late" in an editorial of April 5, 1989. "The Insurance Services Office lies at the center of the storm," they say, "and their moves are far too little, far too late. Advisory ratesetting is not the only questionable competitive practice in the insurance industry. Eliminating it does not answer the question why insurers alone among U.S. businesses cannot function under laws intended to promote competition."

So there is much that we must do. In the last decade we have had two liability crises, we have had an auto insurance revolt, and we are at the doorstep of a major health insurance crisis in this Nation. We have consumer abuses in the selling of medi-gap and in other things. We have deep problems.

The ISO move—what the cartel gives, the cartel can take away, Mr. Chairman. It does nothing about other rate bureaus such as the National Council. It still puts all the ingredients of price-fixing in place through joint loss development, joint trending, and the joint establishment of loss adjustment expense provisions.

As this committee knows, the debate over the McCarran-Ferguson Act last year in the House focused on one key issue, the essence of price-fixing which occurs when they do joint trending, loss development, and joint loss adjustment expense.

It is a remarkably simple step to go from the ISO pure premium, which they project and trend by ISO making their assumptions, to produce a final advisory rate. They even have a cookbook called "Turning Loss Costs Into Final Rates." This cookbook tells you the one-step multiplication process needed to replicate the ISO rate or to produce your own rate.

The cookbook says, "How do you turn a loss cost into a final rate? This is no longer just a question for actuaries. You can convert a loss cost into a final rate by using a relatively straightforward procedure. This booklet will show you in easy-to-follow steps how to do it," and it is a one-step process.

ISO goes further and offers to help insurers by actually doing the multiplication, printing and distributing of the insurers 'nominally independent rate manuals. As the books says, "Once ISO staff multiplies your factor by ISO-based loss costs, you have three options. ISO can provide camera-ready copy, ISO can print the pages and send them to you for distribution, or ISO can print and you can distribute the pages yourself." This is hardly the stuff from which competition is made.

Consider trend. When a building contractor bids on the construction of a building, final costs are not known. There is no ISO-type contractor service office to jointly predict the future for those contractors.

ISO always picks the highest trends and, as a result, they always, in effect, cobble a size 25 shoe so one size fits all. Even if insurers somehow rejected ISO's expense-leading and adopted reasonable expense and profit levels, the resulting prices would be higher than the full forces of competition would produce.

We need to end collusive behavior. The ISO could continue to be a forum for collusion under their voluntary scheme even if they went so far as to knock out trend and loss development, because there is nothing that prohibits, in their action, companies from price-fixing. That is what is allowed by the McCarran-Ferguson Act.

We have learned that what we need is nothing less than repeal of the antitrust law exemptions. We need insurance reform. The people in this country are demanding it from coast to coast. I am sure you hear it.

S. 719 offers a key to real reform of this industry and we are happy to support that and urge adoption of S. 719.

Senator METZENBAUM. Thank you very much, Mr. Hunter.

I am very pleased that Senator DeConcini, a member of this committee, has joined us. I think that he has an opening statement, which will be included in the record.

OPENING STATEMENT OF SENATOR DENNIS DeCONCINI

Senator DECONCINI. Mr. Chairman, thank you, and I do have a statement that I will put into the record.

I see once again we are here at our annual trek to try to fix something that, in my judgment, has not been proved to be broken. I am as alarmed as anyone with insurance rate increases, but it greatly concerns me that we are continuously hearing how Federal legislation is going to improve the situation, with no concrete evidence that it would get better if we altered the McCarran-Ferguson Act today. There is just no evidence that the proposed solution would actually solve the problem.

Second, I think that it is a wrong approach to single out any one part of the problem. We have seen that with liability insurance, we have seen that with health costs and hospital costs, and it doesn't work.

So, Mr. Chairman, I thank you for letting me intervene at this moment, and I ask that my full statement be printed in the record.

Senator METZENBAUM. Without objection, so ordered.

[The prepared statement of Senator DeConcini follows:]

STATEMENT OF DENNIS DeCONCINI

REPEAL OF THE McCARRAN-FERGUSON ACT

APRIL 18, 1989

Mr. Chairman, once again we are convened to hear testimony concerning whether Congress should repeal the McCarran-Ferguson Act. The McCarran-Ferguson Act grants a limited antitrust exemption for the insurance industry and has served the industry and its customers, the American people, well for 40 years. But at least annually, it seems, we meet to hear complaints about how McCarran-Ferguson has allowed the insurance industry to engage in price-fixing, re-sale price maintenance, tying, boycotts, and discrimination.

In the past, proponents of repeal of McCarran-Ferguson have failed to provide us with any evidence that it has restricted competition in the insurance industry, that it has resulted in higher prices for insurance, or that it has made some lines of insurance less available. I am hopeful that this time, we are either presented some evidence of the alleged harm that McCarran-Ferguson has done, or we are able to dispose of this issue for a good long while.

I am concerned about the problems of high insurance costs and lack of available insurance in some areas and in some lines of insurance. I was concerned about these

problems several years ago when the Committee was considering tort reform legislation. I opposed that legislation at that time for much the same reason that I oppose the repeal of McCarran-Ferguson today. First, there was no evidence that the proposed solution would actually solve the problem. And second, I think that it is the wrong approach to single out one party to the problem in the insurance industry and penalize them without closely examining the entire problem in a thoughtful and comprehensive way.

I believed that the approach of tort reform, which attempted to single out victims and their attorneys for sacrifices while allowing the other parties to the problem to continue unscathed, was unfair and would have been unsuccessful. I believe that the proposal before us today is just as unfair and would be an even greater failure. I believe we must look for comprehensive solutions and that if we can move beyond threatening and scapegoating one party or another, those solutions will be found. I would invite all of those who are involved in the whole issue of insurance and personal injury recovery to stop trying to use the issue to gain an advantage over the other parties. I would ask that all parties sit down and engage in some purposeful and meaningful discussions. Perhaps then we can consider proposals that will solve the problem in an effective and non-disruptive way.

The insurance industry is one of the most competitive industries in this country. I am afraid that repeal of the McCarran-Ferguson Act will result in less competition in the industry because it will force the smaller and more innovative companies out of the business of writing insurance. Efforts to impose the full range of Federal antitrust scrutiny on top of the thorough and complete state regulation of the industry will increase the cost of insurance to the consumer. Congress exempted the insurance industry from Federal insurance laws because it was a completely state regulated industry. Congress knew then, and I believe still knows, that the insurance industry is regulated better on the state level than the Federal level.

There has been one significant new occurrence related to this issue in the last few weeks. The Insurance Services Office or ISO recently announced that it will stop issuing final advisory insurance rates to its member insurance companies. ISO is a national nonprofit corporation that is in the business of providing statistical and actuarial data to the insurance industry. The information it supplies is used by the individual insurance companies to determine their long-range costs and to determine what rates they should charge for insurance. The information provided by ISO is available to all property and casualty insurance companies and is also available to state regulators. Now ISO has decided to stop providing advisory rates. The result of this

action will be to force all insurance companies to determine this statistical and actuarial data themselves. I hope that this change in the industry will not increase insurance costs for consumers due to the requirement that all insurance companies individually duplicate what had been done by ISO alone. I believe that Congress should monitor this situation carefully. Certainly, Congress should proceed slowly in imposing any more drastic changes, such as repeal of McCarran-Ferguson, on the industry.

Without evidence that state regulation has failed and without evidence that the McCarran-Ferguson Act has harmed consumers of insurance either through higher prices or unavailability of insurance, I do not believe that we should rush to impose an untried system of Federal regulation that may well worsen, not improve, the situation in the insurance industry.

Senator METZENBAUM. Mr. Hunter, let me ask you—you indicated that every company selling compensation insurance that is a member of the National Council on Compensation Insurance must agree that they will be bound by the filings made by that organization. Are most of the competing insurance company participants in it?

Mr. HUNTER. As far as I know, all of them are.

Senator METZENBAUM. All of them are?

Mr. HUNTER. Yes.

Senator METZENBAUM. So that we do have an instance there of actual price-fixing?

Mr. HUNTER. No question about it.

Senator METZENBAUM. And the State superintendents—what do they say about this kind of joint activity in connection with compensation insurance filings?

Mr. HUNTER. Well, one thing that they do do is they do require typically a rate-filing and a prior approval of these kinds of filings because of the lack of competition in price.

Senator METZENBAUM. They do require a rate filing?

Mr. HUNTER. And, often, a hearing, and usually prior approval—I believe, always a prior approval.

Senator METZENBAUM. But isn't it the fact that most States have the rate file-and-sell arrangements; you just file and go ahead and sell?

Mr. HUNTER. Not in workers comp, typically.

Senator METZENBAUM. Not in workers comp, I see.

Now, most people are familiar with the consumer initiative in California last fall that led to the passage of Proposition 103. I understand the insurance industry—I have heard one figure of $60 million; I have heard another figure of $70 million, to defeat Proposition 103.

Are there other initiatives in other States to roll back insurance premiums?

Mr. HUNTER. Yes.

Senator METZENBAUM. Can you tell us some of those?

Mr. HUNTER. Well, Citizens Action—that consumer organization, through its grass-roots effort, is undertaking similar actions in 14 States. There is action, I know, in Florida. There is considerable agitation in South Carolina currently.

There will be, as the bill is currently drafted in South Carolina, for example, limitations on the amount of expense because of the inefficiency of this industry which occurs as a result of the antitrust exemption. There is gross inefficiency.

So there are movements in Ohio, Pennsylvania. New Jersey has a very active movement underway. There are many States involved.

Senator METZENBAUM. According to the Insurance Information Institute, about 77 cents on every dollar of premium is returned to consumers on paid claims. Do you agree with that figure?

Mr. HUNTER. I would have to see what line of insurance, but, in general, no. In paid claims, it is significantly less, under 50 cents out of every dollar. In incurred claims, which includes estimates of future pay-outs, it might get as high as 65 or so. That 77 probably includes their loss adjustment expense as well as their actual

claims, but it would also include this element of future pay-out potential—not current, actual paid-out.

The current, actual paid-out is typically under 50 cents.

Senator METZENBAUM. Has the insurance industry become accustomed to an environment where collusion is acceptable or do you think that the ISO situation indicates that they are prepared to change?

Mr. HUNTER. I believe so. I believe there are many indications that the insurance industry is realizing that the public is demanding reform in this key area of price-fixing, particularly.

Senator METZENBAUM. Senator DeConcini, any questions?

Senator DECONCINI. Yes, Mr. Chairman.

Let me ask this question. How is the rate pattern in the insurance industry so different from other industries, except for the obvious fact that insurance is regulated by the States and many other industries are not?

In the airline industry, if one carrier announces a fare increase, so often that is followed by the other air carriers. If one airline starts a frequent-flyer program doubling the miles, they usually come up with something better along that line, and I consider myself an expert in that line of travel.

Why do all these costs come out about the same? Aren't these all examples of strenuous competition, and why doesn't that work, in your opinion, in the insurance industry?

Mr. HUNTER. Well, it doesn't work because there is a cartel-set price or level. The difference between what you just said is that the focus is on the most competitive, typically. In airlines, if someone offers you a very low fare or a very good frequent-flyer program, you tend to want to fly that.

In insurance, the focus is on the least efficient. That is who sets the game.

Senator DECONCINI. Let me interrupt you. Aren't they competing with each other, so isn't it the same thing? You know, I mean one raises the price and the other one raises the price.

Mr. HUNTER. Not if they raise it together.

Senator DECONCINI. One goes into a fare war and cuts the price.

Mr. HUNTER. The touchstone in other industries is the low-price competitor. In the insurance industry, the touchstone for all the competition to flow, to the extent there is competition—and there are periods of time when there is none.

But if you are in a period of the cycle where there is competition in a line, the touchstone is not the low-cost; the touchstone is the ISO rate. The high-cost provider becomes the basis from which everybody makes decisions. That is exactly the opposite of the normal case.

Senator DECONCINI. I will ask one other question and then I will submit some, Mr. Chairman.

Do you anticipate that if the McCarran-Ferguson Act was repealed, the insurance companies would find themselves in a situation where some State regulation required an action that was prohibited by an antitrust law?

Mr. HUNTER. Yes, that is possible, of course.

Senator DECONCINI. Under the Metzenbaum proposal, is it clear under this legislation which law would apply, or would that question have to be left to the courts?

Mr. HUNTER. Well, as the chairman said, I think he is willing to try to clarify it if there is anything confusing. But, clearly, under the State action doctrine, it seems that there would be a right for a State, if it met the standards of the State action doctrine, to require joint action, for example.

Senator DECONCINI. If it weren't clear in the legislation that the preeminence was on the Federal level, then your feeling is that the State could go ahead and regulate it?

Mr. HUNTER. Yes. It would have to meet the State action doctrine, but if it did that, then it seems—I am not an attorney, but my understanding is from talking to antitrust attorneys that the State action doctrine would apply in that kind of a case.

Senator DECONCINI. Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you, Senator DeConcini.

Senator Specter, we are very happy to have you with us this morning.

Senator SPECTER. Thank you, Mr. Chairman.

We had experienced a substantial problem a few years ago of the unavailability of insurance and the increase in rates of insurance, and they were, of course, interrelated. There was a suggestion that it may have been as a result of collusion among the insurance companies.

A question that I have asked repeatedly over the course of the past several years when we have had these hearings and when I have met with people on both sides of this issue is, is there any evidence that collusive practices produced the problem of the unavailability of insurance and the cancelation of insurance and the raising of rates.

Let me start with the issue of the unavailability of insurance. Several years ago, there was a tremendous problem with quite a number of municipalities, and I recall a playground in Lancaster, PA, couldn't get insurance. Has that problem abated?

Mr. HUNTER. Yes.

Senator SPECTER. Insurance is now available. Does anybody disagree with that?

[No response.]

Senator SPECTER. How about the issue of rates? There was a real problem in the casualty industry several years ago with the contention of inadequacy of rates. Are the rates pretty much stabilized at this point?

Mr. HUNTER. It depends on the line of insurance, but liability insurance rates actually have been declining for at least a year.

Senator SPECTER. All right. How about the third aspect of the question? Was there ever any evidence that the rate increases or the unavailability of insurance was caused by collusive practices among the companies, between the companies?

Mr. HUNTER. That is the thrust of the antitrust lawsuit now that 20 States are part of in court—well, one is a State action, but 19 States in Federal court in San Francisco allege that, yes, sir.

Senator SPECTER. What is the status of that case? It has been pending now for a year or more?

Mr. HUNTER. We just heard from Attorney General Brown of West Virginia that that case will be argued—the legal aspects of that case will be argued in July.

Senator SPECTER. Pre-trial motion?

Mr. HUNTER. On all the motions, and so on, yes.

Senator SPECTER. Just now on the pre-trial motions?

Mr. HUNTER. That is correct.

Senator METZENBAUM. I think he said on all the motions that are pending, Senator Specter.

Senator SPECTER. Motion to dismiss?

Mr. HUNTER. Yes, all the motions.

Senator SPECTER. What are the motions? I hate to be repetitious.

Senator METZENBAUM. I don't know. He did not spell that out.

Mr. HUNTER. There is a McCarran-Ferguson motion.

Senator SPECTER. What is that?

Mr. HUNTER. There is one that says it should be ousted because of the McCarran-Ferguson Act.

Senator METZENBAUM. He said there were so many lawyers in the room that the judge commented on that. So my guess is you have got a host of motions filed by lots of different lawyers.

Senator SPECTER. It just seems hard to see the case concluded on pre-trial motions, on motions to dismiss, but I am not conversant with the litigation. So the answer is——

Mr. HUNTER. The case will not be concluded. All these motions will be decided and then the case will go forward, various discovery and the like.

Senator SPECTER. There may be a motion to dismiss based on——

Mr. HUNTER. That is one of the motions, yes.

Senator SPECTER. Well, if that is granted, the case is concluded. Well, all right. I am still looking for evidence on that issue, and it may be that that case will produce it or it may be that it won't produce it.

Let me raise one other question.

Mr. HUNTER. Let me just say one thing. Attorney General Brown did say before you came in that one of the things they could not pursue, of course, because of McCarran, was price-fixing during that time.

Senator SPECTER. I didn't understand that.

Mr. HUNTER. The Attorneys General could not pursue the issue of price-fixing because they recognized that the McCarran Act allowed that.

Senator SPECTER. The other question I have is on the problem of potential insolvency, widespread insolvency in the industry. There was a major article on the front page of the New York Times several weeks ago.

Senator Metzenbaum and I were just chatting for a moment about the bill which is pending now on savings and loans, and I regret that I couldn't be here earlier, but I had an amendment this morning. It was actually on the DC crime bill, but I was occupied on the floor.

Do we know anything more than the sketchy newspaper accounts that major insurance companies may face real problems of insolvency and may pose an issue for the Congress similar to the ones we now face—well, they won't be the same as the savings and

loans because we haven't guaranteed anything in the insurance field, but what kind of a problem might we expect in the reasonably near future, if any, on massive insolvencies to threaten a major, vital industry for the country?

Mr. HUNTER. I don't see any major problem. In the mid-1970's, we had a very serious problem. One of the key measures is how much premium is the industry writing against their surplus that is backing up the business, and currently we are under two-to-one, which is considered a safe ratio as an industry as a whole. So the industry as a whole is in quite solid shape.

Now, obviously, there can be outlier companies that have problems. Back in the mid-1970's, we were at three-to-one when GEICO was on the ropes, and so on. There were much more serious concerns during that time, in my estimation.

Senator SPECTER. The light is red and the chairman has handed me a note marked "time." Thank you very much.

Senator METZENBAUM. Thank you very much, Senator Specter.

Mr. Hunter, thank you very much.

Mr. HUNTER. Thank you very much for accommodating my schedule.

[The prepared statement of Mr. Hunter follows:]

STATEMENT OF

J. ROBERT HUNTER
PRESIDENT,
NATIONAL INSURANCE CONSUMER ORGANIZATION

"MODIFICATION OF THE McCARRAN FERGUSON ACT"

BEFORE THE

JUDICIARY COMMITTEE

OF THE

UNITED STATES SENATE

April 18, 1989

121 N. Payne Street
Alexandria, Virginia 22314
(703) 549-8050

Good morning, Mr. Chairman and members of the Committee.

The National Insurance Consumer Organization enthusiastically endorses S. 719, the "Insurance Competition Improvement Act of 1989."

As you know, support for repeal or amendment of the anti-trust exemption insurers enjoy is broad-based. I attach a partial list of those interested in such action (See Exhibit 1). As you see it ranges from consumer groups to bankers, from civil rights organizations to small business groups, from professionals to labor unions. The list includes Consumers Union, AARP, Small Business Legislative Counsel, American Bankers Association, AFL-CIO, American Nurses Association, National Association of Attorneys General, Citicorp, Business and Professional Women, and the American Bar Association. A remarkably diverse group of supporters for change.

I also attached editorials of support from Business Week and the Journal of Commerce (see Exhibit 2).

Why does such a broad agreement for change exist? Because price-fixing, tying of sales, cut backs of coverage, resale price maintenance and other anti-competitive practices, so un-American in the rest of our Nation's free economy, abound in the insurance industry.

As a result, insurance is not fully competitive.

As a result, insurers have become fat, inefficient and wasteful.*

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* See attached Exhibit 3 -- it shows possible savings if the insurance industry were more competitive and thus more efficient.

As a result, we pay too much for insurance in America. It is time for reform.

What are some of the anti-competitive practices in insurance?

Attached is documentation of certain anti-competitive practices which are legal under the McCarran-Ferguson antitrust exemption and which the insurance industry currently engages in. If the antitrust exemption were repealed, insurers could no longer engage in these practices.

1. Rates in the insurance industry are often promulgated by rating bureaus -- industry sponsored organizations which collect and disseminate cost and price information. The rating bureau to which all worker's compensation insurers belong, called the National Council on Compensation Insurance (NCCI), requires its members to use the rates it issues. If the antitrust laws applied to insurance, this would be per se illegal price-fixing. Article VII of the rating bureau's Constitution, the provision requiring its members to use its rates (except in the states that prohibit them from doing so), is attached as Exhibit 4.

2. An insurance company often refuses to sell a certain policy to a consumer unless the consumer also buys a second type of insurance policy. If the antitrust laws applied to insurance, this would be a per se illegal tying arrangement. A letter from Allstate to a policyholder refusing to sell him a personal umbrella policy unless he also buys auto and homeowner's insurance from Allstate is attached as Exhibit 5.

3. Each quarter ISO compiles a document which lists the current prices charged for auto and homeowners insurance by each

of the leading insurance companies in each state. The document also contains the rate ISO "advises" the companies to charge. The ISO makes this document available to insurance companies, but not to insurance consumers. If the antitrust laws applied to insurance, ISO would be required to make the document available to buyers if it made it available to sellers. That would help consumers shop more wisely. A page from an ISO circular comparing prices charges by leading insurance companies in the District of Columbia is attached as Exhibit 6.

4. The Insurance Services Office (ISO) currently issues so-called "advisory" rates for many different types of property and liability insurance. ISO calculates its "advisory" rates by first estimating how much the industry is likely to pay out in claims and defense fees in the future by multiplying past payouts by factors based on ISO's estimate of future inflation and litigicusness, among other things. Today, ISO arrives at its advisory rates by then adding in estimates for agents commissions and other selling expenses; general expenses; taxes, licenses and fees; and underwriting profit and contingencies. They set rates at a level high enough to allow all insurance companies, even the most inefficient, to make a profit. ISO files these "advisory rates" with many state insurance departments, and insurance companies may legally charge the rate ISO "advises" companies to charge.

ISO has recently announced that it will change this process, a step which the Journal of Commerce calls "Too Little, Too Late". (See attached editorial -- Exhibit 7.)

We agree that this move is too little and too late. What the cartel gives the cartel can take away. It does nothing about other rate bureaus, such as NCCI. ISO will still put all of the ingredients of price-fixing in place through joint loss development, joint trend, and the joint establishment of loss adjustment expense provisions. It's move is a good P.R. step, intended to deter your action, but substantively it changes little.

As this Committee knows, the debate over the McCarran-Ferguson Act last year in the House focused on one key issue -- the essence of price-fixing -- trend, loss development, and loss adjustment expense.

It is a remarkably simple step to go from ISO's advisory pure premium calculated by ISO making assumptions about trend, loss development and loss adjustment expenses for the industry to replicate the ISO's advisory rate. ISO even has produced a "Cook-Book" circular describing the step (called "Turning Loss Costs into Final Rates - A 'How To' Guide for Insurers."). This book is used in 28 states where today, ISO only issues loss costs for personal lines (ISO, in three states, uses this technique for commercial lines as well). This change is hardly radical -- they use it in over half the states today! To quote from this ISO booklet:

> "How do you turn a loss cost into a final rate? This is no longer just a question for actuaries . . . you can convert a loss cost into a final rate using a relatively straightforward procedure. This booklet will show you, in easy to follow steps, how to develop manual rates for your company from ISO advisory loss costs."

This can be used, as the booklet points out, to produce independent prices or to produce ISO prices since:

> "ISO . . . continues to collect countrywide expense data to assist insurers in determining their own expenses. We include this data in Countrywide Insurance Expense Experience Circulars."

The process of converting loss costs to ISO rates boils down to a single one-step multiplication. The procedure goes like this: If the ISO expense provision is, say 31.5% and the ISO profit is 5.0%, the total is 36.5%. The factor to convert an ISO generated pure premium to an ISO advisory rate is 1.575 (1 / 1.00 - .365).

For all intents and purposes, ISO's action does not remove the ISO advisory rate from the market. ISO offers to "help" insurers by doing the multiplication, printing and distributing the insurers nominally "independent" rate manuals. To quote from the Cook Book: "Once ISO staff multiplies your factor by ISO base loss costs, you have three options:

* ISO can provide camera ready copy so you can do your own printing;

* ISO can print the pages and send them to you for distribution;

* ISO can print and distribute the pages to manual holders directly."

This is competition?

No one argues that actual historic loss data should not be made available to all insurers and to the public. It should. The question is, should insurers be able to jointly manipulate that data to project how much they think the reserves will settle for and how much inflation and litigation will change the in the

future. ISO argues that only it must "help" insurers determine these future costs. We see such "help" as price-fixing assistance.

Consider trend to cover estimates of the future (inflation, litigation, etc.). When a building contractor bids on the construction of a building, the final costs are not known. Brick prices may change. So might other costs. Labor costs may have to be renegotiated. Other contractor/bidders are in competition with each other on these estimates. The prime contractor may reduce his risk (but raise his quote) by locking in bids from the subcontractors (who act like reinsurers for the prime contractor).

There is no ISO-like "Contractors Services Office" to project the future for contractors.

Without rate bureau's jointly predicting the future, projections will vary by insurer as they do by contractor/bidder. Estimates of inflation will vary. This sort of judgement is the essence of competition. ISO always picks the highest possible exponential trend to assure that its least effective member has enough loss dollars to stay solvent. The difference between ISO and other actuaries on trend can be extremely significant -- sometimes 20 or 30% of the final price.

Loss adjustment expense (LAE) is another example of unwarranted joint pricing. Some insurers say "sue me" while others work hard to settle quickly. These different philosophies seem to produce different levels of expense. Further, some insurers may use agents to do some of the adjusting and others

may not. Attorneys have approached some insurers with proposals to take over a fixed percentage of the loss adjustment litigation for the next year for a fixed fee (like a sub-contractor might). Most insurers have no such arrangement with defense counsel.

The ISO loss adjustment, trend and development shoe fits all sizes only because ISO always selects size 25. Even if insurers somehow rejected ISO's expense leading and adopted reasonable expense and profit levels, the resulting prices will still be higher than full competition would produce.

The ISO change is also too little because, for consumers to feel assured that the era of collusive behavior is over, we need to end collusive behavior. The ISO could continue to be a forum for collusion under their scheme, even if they went so far as to knock out trend, development and LAE. ISO could reverse itself when the McCarran effort was cooled. The ISO would continue to be a meeting place on price because antitrust laws don't apply to such meetings. Certainly ISO would continue to be the focus of the industry rather than the market leaders; thus the highest projections will continue to shape the market rather than the lowest as is the case in other industries under antitrust law.

The ISO change is too late because we have learned that what we need is nothing less than repeal of the federal antitrust law exemptions. As long as the antitrust laws don't fully apply to insurers, consumers cannot trust joint meetings even if they appear to pertain only to historic data collection efforts.

ISO, of course, can not penalize insurers if they sat down and discussed final rates at ISO even if such final prices are not sent out.

America needs insurance reform. The people are demanding it from coast to coast. S. 719 offers a key to real reform of this industry. NICO urges that the Committee adopt S. 719.

Exhibit 1

Groups Interested in Repeal or Amendment of McCarran-Ferguson

Small Business Legislative Council
Consumers Union
National Federation of Business and Professional Women's Clubs (BPW/USA)
National Council of Senior Citizens
U.S. Public Interest Research Group
American Federation of Labor -- Congress of Industrial Organizations (AFL-CIO)
Consumer Federation of America
American Association of Nurse Anesthetists
Texas, Colorado, and Illinois Associations of Nurse Anesthetists
National Insurance Consumer Organization
Consumer Bankers Association
American Association of Retired Persons
Amalgamated Transit Union
Environmental Policy Institute
Environmental Action
Public Citizen's Congress Watch
National Association of Women Business Owners
Women's Equity Action League
American Nurses Association
Association of American Physicians and Surgeons
National Association of Attorneys General
American Bankers Association
Business and Professional Women
Citicorp
American Association of University Women
National Women's Health Network
Federal Trade Commission
American Association of Colleges of Nursing
American Society for Medical Technology
Auto Services Dealers
Citizen Action
American Bar Association
Society of Collision Repair Specialists (SCRS)

Exhibit 2
(Page 1)

Editorials

130 BUSINESS WEEK/APRIL 11, 1988

THE INSURANCE CARTEL IS RIPE FOR BUSTING

A smoke-filled room in which "competitors" set prices and carve up markets is the setting often associated with violators of antitrust laws. Unless, that is, the competitors belong to the $350 billion U. S. insurance industry. The 1,400 or so property-and-casualty underwriters routinely set prices, citing nationally published rates rather than establishing their own (page 60). And it's all perfectly legal under the 1945 McCarran-Ferguson Act, which circumvented a Supreme Court decision subjecting the state-regulated insurance industry to federal regulation for the first time. McCarran-Ferguson bars Washington from overseeing the insurance industry, specifically exempting it from antitrust laws.

It's high time to scrap this legislative anomaly. The fruits of joint action by the industry, ranging from sky-high premiums for day-care centers to absolute refusal to insure some businesses, are increasingly bitter. Lawmakers should adopt the bills now pending in the House and Senate outlawing the most egregious conduct of the industry while protecting the few joint activities that are beneficial. A bill pending in the Senate would permit the industry to continue gathering data industrywide, coordinating the underwriting of large risks for businesses and municipalities, and offering lines of coverage jointly for the hard-to-insure. The legislation would also let insurers establish guaranty funds to cover each other's bad debts.

But the legislation would ban the kind of coordinated action that leaves businesses without coverage, even though they have never filed a claim. The sooner Congress acts to end this cartel, the better off we'll all be.

The Journal of Commerce, May 25, 1988, Editorial Exhibit 2

(Page 2)

End McCarran-Ferguson

INSURANCE COMPANIES HAVE ENJOYED for too long the protection of an antitrust exemption that permits price discussion without fear of prosecution. This immunity keeps rates artificially high, impedes competition and, industry claims to the contrary, is not essential to collect the data insurers need to chart a successful business course.

Many of the 3,500 property/casualty insurance companies in the United States are local concerns. Most insist they can write a variety of insurance lines only because they have access to historical data from an industry organization called the Insurance Services Office. That group also uses its actuarial expertise to suggest rates to its members.

Proponents of the McCarran-Ferguson Act, which provides the antitrust immunity necessary to create suggested rates, defend the system as a way of retaining the competition and underwriting capacity of thousands of companies.

But combining pricing data from well-run and poorly run companies, as the Insurance Services Office does, ultimately produces suggested rates that are higher than justified. The result is excessive insurance premiums.

One of the aims of the recent antitrust suit by state attorneys general against large segments of the industry is to break up the Insurance Services Office. Another strategy for attacking McCarran-Ferguson is evolving in the House Energy and Commerce Committee, where moves to have the federal government collect data on the insurance industry are being linked to pending legislation to reform product liability law.

Insurers steadfastly object to changes in McCarran-Ferguson or to any form of federal data collection. They insist that there is no alternative to the familiar Insurance Services Office. This stance is not only unjustifiable, but is detrimental to some insurers.

Antitrust immunity is not vital to the insurance industry. Insurers' need for data is legitimate, but there is no reason that data cannot be provided by consultants working for individual firms. On major policy issues, many trade groups in industries such as banking and steel employ economic analysts to recommend a unified course of action for the industry. The insurance industry could turn to similar sources, although pricing would be off limits.

Reducing the sharing of insurance information could result in costs that some companies could not bear. But many small businesses fail at the hands of larger competitors. It is up to smaller companies to find a service or a market niche in which they can survive.

Meanwhile, antitrust immunity gives the insurance industry a major political problem. Every issue, from product liability law reform to information gathering, becomes a fight over whether insurers are hiding something under the cloak of McCarran-Ferguson.

Competition in insurance, as this newspaper's extensive daily coverage of the industry confirms, works to the benefit not only of buyers of insurance, but of the better-managed insurers as well. Eliminating antitrust immunity is an important step in increasing that competition.

Exhibit 3

1987 Expense Ratios

Line	Average All Companies			An Efficient Writer With at least 1% of National Market			An inefficient writer with at least 1 % of National Market			Potential Rate Savings*	
	Loss Adjustment	Underwriting	Total	Loss Adjustment	Underwriting	Total	Loss Adjustment	Underwriting	Total	If Average Became Efficient	If Inefficient Became Efficient
Fire	4.1%	37.7%	41.8%	2.8%	22.3%	25.1	3.9%	54.0%	57.9%	-22%	-44%
Allied	6.0	32.9	38.9	3.9	21.9	25.8	13.2	35.7	48.9	-18	-31
Farmowners	7.7	31.6	39.3	5.0	17.4	22.4	9.0	45.3	54.3	-22	-41
Homeowners	9.4	30.7	40.1	9.4	7.2	16.6	17.2	44.4	61.6	-28	-54
CMP	12.3	34.0	46.3	7.0	22.8	29.8	23.0	40.1	63.1	-24	-47
Inland	5.2	34.1	39.3	8.6	8.4	17.0	11.5	36.1	47.6	-27	-37
Med/Mal	30.3	12.7	43.0	6.8	5.9	12.7	49.3	20.2	69.5	-35	-65
Earthquake	5.0	30.4	35.4	0.7	6.5	7.2	1.0	55.7	56.7	-30	-53
Other Liab.	23.4	22.0	45.4	14.9	12.0	26.9	24.7	43.9	68.6	-25	-57
PP Auto Lia.	12.5	22.8	35.3	11.5	8.5	20.0	13.3	25.4	38.7	-19	-23
CC Auto Lia.	12.2	25.7	37.9	10.6	6.5	17.1	12.4	30.2	42.6	-25	-31
PP Auto Phys	7.6	22.8	30.4	8.9	10.8	19.7	5.1	42.1	47.2	-13	-34
CC Auto Phys	5.7	28.8	34.5	5.7	16.4	22.1	7.0	44.8	51.8	-16	-38
Aircraft	6.4	22.8	29.2	7.9	11.2	19.1	6.5	27.6	34.1	-12	-19
Fidelity	5.9	27.3	33.2	1.3	14.7	16.0	13.9	39.0	52.9	-20	-44
Surety	11.0	59.3	70.3	22.5	8.2	30.7	0.5	90.2	90.7	-57	-87
Burglary	4.8	37.7	42.5	0.4	15.0	15.4	4.8	64.8	69.6	-32	-64
B & M	4.1	48.9	53.0	4.5	34.4	38.9	0.0	69.3	69.3	-23	-50
Total	11.7	25.2	36.9	11.3	11.7	23.0	15.5	30.0	45.5	-18	-29

*Calculated as follows: (1.000 - expense ratio of inefficient writer/ 1.000 - expense ratio of efficient writer) - 1.000

SOURCE: A.M. Best Aggregates and Averages, 1988

Exhibit 4

Constitution
of
National Council on Compensation Insurance

Reprinted as of
April 4, 1985

ARTICLE VII

MEMBERS, SUBSCRIBERS AND SERVICE PURCHASERS

1. Any insurer writing workers compensation insurance may become a member of the NCCI by accepting the obligations of membership for all states in which such insurer writes workers compensation insurance.

2. Any insurer writing workers compensation insurance may become a subscriber to the services of the NCCI for any state or states in which such carrier writes workers compensation insurance by accepting the obligations of subscribership with respect to the state or states designated by it.

3. Each member shall:

   (a) Comply with the provisions of this Constitution and with all rules and regulations made hereunder;

   (b) Report periodically to the NCCI such statistical information for the states in which such member writes workers compensation insurance, as the NCCI may require;

   (c) Adhere to all filings made by the NCCI on its behalf with state supervisory authorities, except to the extent that

      (i) Such member shall obtain the right to depart from such filings in accordance with the requirements of law specifically applicable thereto, or;

      (ii) The applicable law precludes, either directly or indirectly, agreements to adhere to such filings;

   (d) Pay charges and assessments levied against it;

   (e) Execute such authorizations and other documents as may be required of it by the NCCI.

Allstate

Exhibit 5

California Regional Operations Center
P.O. Box 25115
Santa Ana, CA 92799
714-579-8759

Date: March 30, 1987
Policy Number: 04 838 533
Type of Policy: Personal Umbrella
Termination Date: June 17, 1987

Richard E. Rosengarten
8535 W. Knoll Drive 212
W. Los Angeles, CA 90069

Dear Mr. Rosengarten:

Recently, much has been said and written about the liability problems affecting society today. While most of the impact has been felt in the business and professional community, it has not left untouched families and individuals.

As a holder of an Allstate Personal Umbrella Policy (PUP) you have already recognized the need for excess coverage to protect your financial assets to a greater degree than that found in a normal auto or homeowner policy. Allstate wants to continue to provide this valuable protection for you. However, due to the tremendous increase in the number and cost of liability claims, we find it necessary to require that the primary liability coverages afforded by the homeowner and auto policy be with Allstate.

This is necessary for two reasons. First, it is extremely difficult for us to continually verify the required underlying auto or property coverages if they are with another company. Second, when two companies are involved in the same claim, problems can occur. For example, if your primary liability limits are with another carrier and a large claim occurs, we may not even be aware of the claim until the primary limits are exhausted. Therefore, we may be bound by the claim procedures and practices of the other company, one result possibly being less than ideal claims service to you.

In reviewing your Personal Umbrella Policy records, we find that the primary policies (Automobile and Homeowners) for which the Umbrella Policy provides excess liability, are not presently carried with Allstate. We are therefore unable to renew your protection under the Personal Umbrella Policy shown above and it will expire at 12:01 a.m. on June 17, 1987.

Please note this action does not change the status of your current (auto or property) policy. If you desire to continue your PUP policy with us, please contact your Allstate agent immediately. It is our sincere hope that we can continue to provide this coverage for you.

Cordially,

Allstate Insurance Company

cc: Rick Oksas Loc 523

Ref: pup-nr-1

Exhibit 6

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HOMEOWNERS PREMIUM COMPARISON

Page 1

CONSTRUCTION Masonry FORM 1 TERRITORY 01

STATE: DISTRICT OF COLUMBIA

SECTION II - $25,000 COMPREHENSIVE PERSONAL LIABILITY & $500 MEDICAL PAYMENTS

REPORT DATE: May 14, 1982

PROT. CLASS	POL. AMT. (000)	ISO	AETNA L&C GRP Aetna C&S & Standard Fire Ins Cos	ALLSTATE INSURANCE GROUP Allstate Ins Co	FIREMEN'S INSURANCE GROUP DC Firemen's Ins of DC	GEICO CORP GROUP Gov't Employees Ins Co	HARTFORD INSURANCE GROUP Hartford Fire Ins Co	HARTFORD INSURANCE GROUP Hartford A&I Co	NATION-WIDE CORP Nation-wide Mut Fire Ins Co	REPUBLIC FIN SERV GROUP Blue Ridge, Republic & Vanguard Ins Cos	STATE FARM GROUP State Farm F&C Co	TRAVELERS INSURANCE GROUP Travelers Indemnity Co	TRAVELERS INSURANCE GROUP Phoenix Ins Co Economy Home Pac
	30	63	63	68	63	57	63	54	63	63	66	68	58
	50	116	116	121	116	104	116	99	116	116	119	125	106
2	75	182	181	186	182	164	182	155	182	182	185	197	167
	100	247	246	250	247	222	247	210	247	247	250	268	228
	150	377	376	378	377	339	377	320	377	377	380	408	347
	Eff. Date	9-73	9-73	5-3-82	9-73	12-4-80	9-73	7-1-80	9-73	9-73	10-1-78	11-16-79	11-16-79

Exhibit 7

Too Little, Too Late

THE INSURANCE SERVICES OFFICE lies at the center of the storm over the insurance industry's cherished exemption from federal antitrust law. As the industry faces its strongest political challenge in decades, the 1,400-member trade group announced Monday that it no longer will issue "advisory" insurance rates and that it will include "public" members on its board. Those moves are far too little, far too late.

Ever since 1945, insurers have enjoyed a privilege of which companies in other industries can only dream. They may share confidential business information freely. That right is protected by the McCarran-Ferguson Act, which grants insurance companies a blanket exemption from federal antitrust law except in cases of boycott, coercion or intimidation.

The Insurance Services Office is a product of that antitrust exemption, collecting information about the risks for which customers seek insurance, estimating prospective loss costs and suggesting the rates insurers should charge. Most consumers and small business owners meet the ISO only when a company to which they have applied for insurance asks the office's appraisers to inspect their property. The ISO also issues standardized policies for products such as homeowners or product liability insurance, allowing customers to compare the costs of different insurers' policies with the knowledge that each policy offers precisely the same coverage.

No insurer is bound by the ISO's recommended rates, and for many types of property and casualty insurance the office's recommendations are widely disregarded. But there are areas, notably homeowners and auto insurance, in which the ISO's suggested rates have a powerful impact on the marketplace. And the ISO's decisions on policy forms can shape the insurance market: An antitrust suit filed last year by the attorneys general of 19 states charges, among other things, that the ISO's recommendations to eliminate certain types of losses from coverage under the liability policies sold to local governments amounted to an illegal boycott.

The antitrust suit and public anger over rapid increases in insurance premiums, expressed most strongly in California voters' approval of a referendum rolling back auto insurance rates last year, have lent momentum to the effort to reform McCarran-Ferguson. That effort has brought the ISO under unaccustomed public scrutiny. The organization's announcement that it would abandon rate-

making comes in direct response to a proposal before the National Association of Insurance Commissioners, a group not known for its hostility toward the industry, that issuance of advisory rates be prohibited.

But advisory rates are only one of the problems associated with an industrywide institution that collects and distributes sensitive business information. Even though the ISO no longer will recommend rates, it still will publish all of the loss data individual companies need to calculate their own rates. And it will continue to issue standardized policy forms — a benefit to comparison shopping by individual consumers, but a hindrance to business customers who wish a type of coverage the industry refuses to make available.

The ISO, and insurance industry trade groups, have long contended that the information the ISO provides under the antitrust exemption is critical to the insurance industry's survival. In fact, larger insurers have little need for the ISO's data in most cases; their own loss histories give them the information they need to determine premiums. Obtaining others' information about loss experience is more important to smaller companies, but even that does not offer sufficient reason to maintain a single source of data. Consultants working for individual firms, or data collection organizations established by small groups of insurers, could provide the industry the information it needs while bringing more competition to the insurance marketplace.

Naming three "public" members to the organization's 24-member board, a response to the request of the attorneys general that the ISO's directors be replaced by public interest representatives, is an inadvisable attempt to make the public a party to the ISO's actions. Insurance is not and should not be a public utility. Bringing "public" representatives into an internal industry body only strengthens the impression that that body engages in activities that are not appropriate in a market economy.

By moving to end the issuance of advisory rates, the ISO wisely recognizes that the practice has given the insurance industry a black eye by strengthening the public perception that it fixes prices. Addressing the industry's public relations problems is commendable. But advisory rate-setting is not the only questionable competitive practice in the insurance industry. Eliminating it does not answer the question why insurers, alone among U.S. businesses, cannot function under laws intended to promote business competition.

Senator METZENBAUM. The chairman handed you a note because he is figuring how is he going to hear from seven more witnesses and conclude this hearing at around 12:00, which I think is an impossibility.

Senator SPECTER. There is no harder-working chairman than Senator Metzenbaum. On these hearings, consistently, at about 11:32 we face eight witnesses.

Senator METZENBAUM. That is exactly right. I just spoke to my staff about that. I ought to blame it on somebody.

Mr. Serota, we are happy to have you with us and very pleased that the ABA has taken a position in connection with this subject.

STATEMENT OF JAMES I. SEROTA

Mr. SEROTA. Thank you, Mr. Chairman. Mr. Chairman, members of the committee, thank you for allowing me to present this testimony on behalf of the American Bar Association.

My name is James Serota and I am a partner in the New York City law firm of Huber, Lawrence and Abell. I am appearing on behalf of the ABA President, Robert Raven, who requested that I express the position of the association. My appearance today is solely on behalf of the American Bar Association. The following is a summary of my prepared statement which is submitted for the record in its entirety.

The McCarran-Ferguson antitrust exemption, which provides certain limited antitrust immunity for the business of insurance, was established by Congress in 1945 as an attempt to reaffirm the supremacy of State regulation of insurance in response to a Federal criminal antitrust challenge to a variety of anticompetitive acts.

The question for today is whether the McCarran-Ferguson Act continues to serve its original purpose or whether the American public, as well as the insurance industry, would be better served by repeal of the McCarran-Ferguson Act.

The ABA recommends that the American insurance industry be subject to the same antitrust laws as all other American business, although safe harbors should be delineated for certain collective activity that is generally accepted among antitrust lawyers as procompetitive.

In February of 1987, the ABA's House of Delegates authorized the appointment of a broadly-based commission to study and make recommendations regarding the liability insurance system. A copy of the full ABA commission report has previously been sent by the ABA to each member of both Judiciary Committees. Another copy is today submitted to your committee for its records.

In response to the ABA commission report, the ABA's House of Delegates this year adopted a resolution containing the following two major recommendations. One, the current McCarran-Ferguson exemption to the antitrust laws should be repealed and replaced with legislation containing features which spell out permissible collective behavior.

Two, States should retain the authority to regulate the business of insurance. The Federal Government should defer to State regulation with limited exception.

Although repeal of the McCarran-Ferguson exemption would create some uncertainty, that is the normal uncertainty which accompanies a change to competition. Dynamic change and the fear of losing business is what competition is all about.

Throughout its report, the ABA commission recommends enhancing competitive market forces as a means of improving the insurance industry. The continued existence of the McCarran-Ferguson exemption is inconsistent with that objective.

In order to deter unwarranted private litigation, the ABA also recommends that legislation contain a nonexclusive list of safe harbors of cooperative activities that should be permitted after McCarran-Ferguson is repealed. Let me list some of them: one, data collection, but not the use of data to form advisory rates or their functional equivalent; two, policy standardization, with freedom to choose; joint underwriting agreements or insurance pools; four, residual market mechanisms.

In general, the ABA supports three criteria for judging other possible antitrust safe harbor insurance exemptions, as set out by the National Commission for Review of the Antitrust Laws in 1979.

First, is the proposed joint activity so important to the insurance process that uncertainty as to its legal status would severely limit the ability of the industry to function in an efficient and competitive manner?

Two, is the activity in question one presently subject only to antitrust principles of broad generality rather than relatively detailed case law that would eliminate its antitrust legality?

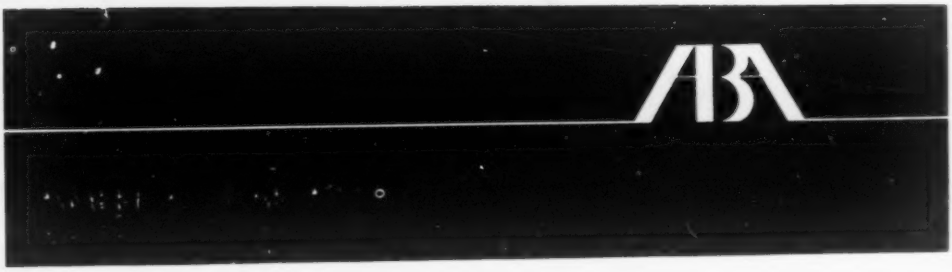
Three, under rule of reason analysis, would the activity in question be found to have the probable effect of not lessening competition within the industry?

McCarran-Ferguson is a powerful symbol of the primacy of State regulation. However, there is nothing in the repealed exemption that suggests Federal authority beyond application of the antitrust laws. Congress should not preempt State regulatory regimes with Federal regulation directed at the business of insurance. The tradition of State regulation shared by insurance industries and the adjustment of the industry to State regulatory requirements should not be discarded lightly.

In conclusion, let me emphasize that the ABA believes that the competitive nature of insurance markets can be enhanced consistent with necessary joint activities and consistent with State regulation and our Federal system, to the benefit of all segments of this Nation's society.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Serota follows:]



STATEMENT OF JAMES I. SEROTA

Chair, Insurance Industry Committee,
Antitrust Law Section

On Behalf of the

AMERICAN BAR ASSOCIATION

Before the
Committee on the Judiciary,
United States Senate

Concerning Repeal of the McCarran-Ferguson Act

April 18, 1989

Mr. Chairman and members of the Committee, thank you for allowing me to present this testimony on behalf of the American Bar Association. I am appearing on behalf of the ABA President, Robert D. Raven, who requested that I express the position of the Association. My name is James I. Serota. I am a partner in the New York City law firm of Huber Lawrence & Abell. My appearance today is solely on behalf of the American Bar Association.

For the past two years, various groups within the American Bar Association have considered changes to the limited immunity from the antitrust laws provided to the business of insurance. That immunity, commonly known as the McCarran-Ferguson Antitrust Exemption, was established in 1945 as an attempt to reaffirm the supremacy of state regulation in response to a federal criminal antitrust challenge to a variety of anti-competitive acts. The McCarran-Ferguson Exemption compromise prohibited certain clearly anti-competitive acts and reserved to the states the right to develop a system of regulation. In response to this statute, a more pervasive system of state regulation did develop. Historically, that was a period when increasing regulation was accepted as the proper role of government.

This is a different era. The past ten years have witnessed the increasing march of deregulation in favor of free and open price competition in a variety of formerly regulated industries. At the same time, over the last ten years the Supreme Court has increasingly narrowed the scope of what was formerly considered to be a very broad interpretation of the McCarran-Ferguson Act. The question for today is whether the McCarran-Ferguson Act continues to serve its original purpose -- or whether the American public as well as the insurance industry would be better served by repeal of the McCarran-Ferguson Act.

For the reasons which I am about to outline, the American Bar Association recommends that the American insurance industry be subject to the same antitrust laws as all other American businesses, although safe harbors should also be delineated for certain collective activity that is generally accepted among antitrust lawyers as procompetitive.

In February 1987, the American Bar Association's House of Delegates authorized then-President Eugene Thomas to appoint a broadly-based commission to study and make recommendations regarding the liability insurance system. In

response to that directive, a Presidential Commission of the American Bar Association was established which made several recommendations to the ABA House of Delegates to improve the liability insurance system. A copy of the full ABA Commission Report has previously been sent by the ABA to each Member of both Judiciary Committees. Another copy is today submitted to your Committee for its records.

In response to the ABA Commission Report, in February 1989 the American Bar Association's House of Delegates adopted a resolution containing the following two major recommendations:

I. The current McCarran-Ferguson exemption to the antitrust laws should be repealed and replaced with legislation containing the following features:

(1) Insurers should be made subject to general antitrust laws but provided with authorization to engage in specified cooperative activity that is shown to not unreasonably restrain competition in the industry.

(2) Insurers should be authorized to cooperate in the collection and

dissemination of past loss experience data so long as those activities do not unreasonably restrain competition but should not be authorized to cooperate in the construction of advisory rates or the projection of loss experience into the future in such a manner as to interfere with competitive pricing.

(3) Insurers should be authorized to cooperate to develop standardized policy forms in order to simplify consumer understanding, enhance price competition and support data collection efforts, but state regulators should be given authority to guard against the use of standardized forms to unreasonably limit choices available in the market.

(4) Insurers should be authorized to participate in voluntary joint underwriting agreements and in connection with such agreements to cooperate with each other in making rates, policy forms, and other essential insurance functions so

long as these activities do not unreasonably restrain competition.

(5) Insurers participating in residual market mechanisms should be authorized in connection with such activity to cooperate in making rates, policy forms, and other essential insurance functions so long as the residual market mechanism is approved by and subject to the active supervision of a state regulatory agency.

(6) Insurers should be authorized to engage in such other collective activities that Congress specifically finds do not unreasonably restrain competition in insurance markets.

(7) State regulation of insurance rates should not exempt insurers from the antitrust laws under the state action doctrine, except as specified in Recommendation (1) to (6). Other non-rate regulation by a state should not exempt insurers from the antitrust laws unless that regulation satisfies the

requirements of the state action doctrine and the regulation is shown to not unreasonably restrain competition.

II. States should retain the authority to regulate the business of insurance. The federal government should defer to state regulation except in those unusual circumstances where the regulatory objective can only be effectively accomplished through federal involvement.

In adopting these two recommendations, the ABA's House of Delegates was aware of the ABA Commission's finding that the effect of the McCarran-Ferguson exemption on insurance pricing and industry practices varies with the underlying state regulatory environment. Replacement of the McCarran-Ferguson exemption with legislation consistent with the ABA's recommendations may increase the competitive atmosphere of the industry and replace the uncertainty concerning the scope and meaning of the existing exemption. Although repeal would create some uncertainty, there is also uncertainty concerning the scope and meaning of the existing exemption. The existing exemption has a substantial impact on the perceptions of the industry and its critics, and unless the

issue is resolved it may continue to distract policymakers from more central questions of insurance reform.

Throughout its report, the ABA Commission recommends enhancing competitive market forces as a means of improving the insurance industry. The continued existence of McCarran-Ferguson is inconsistent with that objective. The perception is widely held that McCarran-Ferguson permits insurers to manipulate the insurance mechanism and the price of insurance coverage collusively. Clearly, the industry believes the exemption permits cooperative activity that otherwise could raise serious antitrust concerns. These perceptions impede consideration of other proposals which may hold greater promise of moderating availability and affordability problems.

The repeal of McCarran-Ferguson has become a symbol in the debate over causes of dislocations in private insurance markets. The ABA Commission did not believe repeal should be regarded as alone sufficient to improve the insurance system or to avoid future dislocations. The scope of the current exemption from antitrust enforcement is quite narrow, and boycotts remain subject to antitrust laws. Much of the

current concerted activity by insurers is arguably permitted even under the antitrust laws as long as it does not restrain trade. Accordingly, the ABA believes that, in general, the insurance industry should be subject to normal antitrust doctrine, although safe harbors should be specifically provided for cooperative behavior which clearly has legitimate procompetitive consequences.

Those who oppose modification of McCarran-Ferguson cite the instability in insurance markets that could result from the uncertainty associated with legal change and the resulting impact such instability might have on the availability and price of insurance coverage. In the short run, any legal change will produce some uncertainty and incentive for interpretive litigation. But uncertainty should not deter justified change. Although the ABA Commission did not believe that modification of McCarran-Ferguson will result in massive change in insurance practices, the ABA recommends that modifying legislation be carefully drawn and in sufficient detail so that unnecessary uncertainty is avoided.

The ABA recognizes that many oppose repeal of McCarran-Ferguson because they fear subsequent adoption of a pervasive federal regulatory structure for the insurance industry.

Repeal of McCarran-Ferguson does not, however, automatically require further federal regulation and the ABA specifically urges that state regulatory structures be maintained.

In order to deter unwarranted private litigation, the ABA also recommends that legislation contain a non-exclusive list of those "safe harbors" of cooperative activities that should be permitted after McCarran-Ferguson is repealed. In general, the ABA supports the three criteria for judging the appropriateness of antitrust exemptions set out by the National Commission for the Review of Antitrust Laws and Procedure in 1979:

> "first, is the proposed joint activity so important to the insurance process that uncertainty as to its legal status would severely limit the ability of the industry to function in an efficient and competitive manner; second, is the activity in question one presently subject only to antitrust principles of broad generality rather than relatively detailed case law that would illuminate its antitrust legality . . .; third, under a rule of reason analysis would the activity in question be found to have the probable effect of not lessening competition within the industry."

Under its Recommendation feature number (2), the ABA recognizes that the cooperative collection and dissemination of past loss experience should continue to be permitted. The insurance principle requires that insurers track losses over

large numbers of insureds. Particularly for commercial risks where individual insurers may not insure sufficient numbers of similar risks to have adequate data, cooperative collection is essential. A cooperative data base also permits smaller insurers to compete with large insurers. At the same time, interpretation of past data to the point of developing suggested future rates or providing a base line against which future rates can be established tends to narrow the range of price competition in an industry.

For data to be meaningful in an insurance context they must be appropriately classified and this requires some standardization in both the way in which data are reported and the descriptions of the data. This in turn justifies some cooperative agreement on standardized policy language. At the same time adoption of standardized language may reduce competition in coverage definitions to the detriment of insureds. The ABA believes this issue can only be resolved on a case by case evaluation. Recommendation feature number (3) is that standardized policy forms be permitted by federal legislation but that state regulatory agencies be authorized to monitor the activity closely to insure that consumer choice is not unreasonably restrained. In exercising this

authority state regulators should be sensitive to market conditions. The absence of consumer choice is not always unreasonable; it may result from lack of consumer demand or the inability of the industry to provide a profitable alternative.

Some risks may be too large or too uncertain for a single insurer to underwrite; traditionally insurers have cooperated in underwriting such risks. Although antitrust rules governing joint ventures would likely permit such activity in most instances, the ABA believes specific authority should be provided in accordance with Recommendation feature number (4). In underwriting joint risks, insurers must, of course, agree on rates, policy language, and the other essential terms of the insurance transaction. At the same time, joint activity that restrains trade should be unlawful as it is in other industries.

In addition, state regulators have often required insurers to cooperate in underwriting residual risks that cannot be insured in the voluntary market. The ABA Recommendation feature number (5) recommends that cooperative activity leading to the rates, policy forms, and other terms

of such transactions should be permitted as long as it is pursuant to state authorized and actively supervised residual market mechanisms.

Recommendation feature number (6) reflects the ABA's reluctance to adopt an exclusive list of cooperative activities that may be appropriate. Some traditional activities affecting other than liability insurance, such as the on-site inspections for fire insurance underwriting, may enhance competition but are outside the scope of our concerns. The industry may also be able to justify other cooperative activities relating to liability insurance on competitive grounds.

Recommendation feature number (7) reflects the ABA's position that state regulators should not be permitted to undermine the repeal of McCarran-Ferguson by permitting anticompetitive pricing activities under the state action doctrine. This recommendation does not of itself prohibit state rate regulation. However, cooperative insurer activity in response to such regulation should not be automatically exempt under the state action doctrine, but rather should be evaluated under normal antitrust rules relating to restraint

of trade. For example, joint insurer efforts to adopt advisory rates or to adjust actuarial data in concert for future rating might not be permitted.

If current conditions are any guide, most insurance markets are reasonably competitive when actual participants and potential entrants are considered. The ABA recognizes that there are some instances in which state rate regulation is justified, although the major thrust of its recommendations is to enhance market competition. Ordinarily, price regulation would be required only in limited niche markets and in some narrowly defined geographic areas. In these circumstances, cooperative insurer activities may be inevitable in the rate regulation context. Congress should adopt detailed provisions to ensure that, prior to authorizing such concerted activity by regulation, state regulators make and publish findings of the absence of competition in a particular line or class of insurance.

State regulation directed at activities other than pricing should permit cooperative insurer behavior only if the state action doctrine is satisfied. That doctrine requires that anticompetitive activity authorized by

regulation be clearly expressed as state policy and that the state actively monitor the activity. This would effectuate a change from McCarran-Ferguson, which exempts insurer activity from antitrust law even if there is merely passive state regulation. Similarly, state regulators should be able to justify the regulation as one that enhances rather than restrains competition.

Insurers traditionally have been regulated at the state level; for the most part, the federal government has become involved in insurance markets only in unusual circumstances requiring national regulation. The availability and affordability problems of the mid-1980's do not suggest a change in this tradition.

McCarran-Ferguson is a powerful symbol of the primacy of state regulation of insurance. However, there is nothing in repeal of the exemption that necessitates elevating federal authority beyond application of antitrust laws. The ABA's second major recommendation emphasizes that, notwithstanding its recommendation regarding repeal of McCarran-Ferguson, state regulatory authority should be retained. Congress should not preempt current state regulatory regimes with

federal regulation directed at the business of insurance. The tradition of state regulation, the long-standing experience shared by state insurance agencies, and the adjustment of the industry to state regulatory requirements should not be discarded lightly.

At the same time, the repeal of McCarran-Ferguson will intensify the need for independent and adequately funded state insurance agencies. Agencies could enhance the appearance of their independence and their access to broader perspectives if they would formalize the role of consumers in the regulatory process by the appointment of a consumer advocate.

In conclusion, let me emphasize that the American Bar Association, through the action of its House of Delegates in adopting these two major Recommendations, believes that the competitive nature of insurance markets can be enhanced, consistent with necessary joint activities and consistent with State regulation in our federal system, to the benefit of all segments of this nation's society.

Senator METZENBAUM. Thank you very much, Mr. Serota.

Our next witness is Mr. Stephen Brobeck, executive director of the Consumer Federation of America.

STATEMENT OF STEPHEN BROBECK

Mr. BROBECK. Thank you very much, Mr. Chairman. The Consumer Federation appreciates the opportunity to testify in support of the legislation that you introduced. Its passage represents the single most important action that Congress can take to increase competition and efficiency in insurance markets. Its enactment would reduce prices of insurance products, curb deceptive advertising and tie-in sales, and encourage States to eliminate other barriers to competition.

Perhaps the greatest consumer benefit offered by this legislation is increased competition and lower prices in automobile insurance markets. That is the subject that I have addressed in my written testimony and it is the subject that I will speak to briefly now.

Many areas of the country are experiencing an auto insurance crisis. It is not at all unusual for consumers with good driving records to be charged several thousand dollars a year in premiums. Not surprisingly, then, for many families auto insurance is the single largest transportation expense item. For most low-income households, who tend to pay more than do other income groups, it is simply unaffordable.

Although high and escalating auto insurance rates reflect many factors, including rising costs for medical care and auto repairs, the most important is insurer waste and inefficiency resulting from inadequate regulation at the State level and from lack of competition.

The shortcomings of State regulation are well documented. The most striking evidence of lack of competition is the huge range of insurer prices and costs. In competitive markets, prices for equivalent products rarely range more than 50 percent. In auto insurance markets, as evidence presented in our written testimony suggests, they often vary by 300 to 400 percent. Those are prices charged to the same households.

Similarly, insurer costs range widely. Selling costs vary from about 5 percent to more than 50 percent. Thus, it is not surprising that expense ratios vary considerably from 20 percent to over 70 percent. Truly competitive markets would not tolerate such enormous ranges of prices and expense ratios.

There are several barriers to competition, and most are related to the antitrust exemption conferred by the McCarran-Ferguson statute. These barriers include:

One, difficulty of consumer price comparisons. Insurance products are unavoidably complex and price information is not always easy to obtain.

Two, mandatory coverages. Most States require drivers to purchase liability coverage, but most do not require insurers to sell policies. Thus, consumers correctly perceive that they are at a disadvantage in dealing with insurers, so that many are more concerned with availability than with cost.

Three, too few sellers. Despite the existence of a couple thousand sellers nationwide, there is too much concentration in many markets. Twenty-one States have Herfindahl-Hirschman indexes of between 1,000 and 1,800, indicating a moderate level of concentration, while one has an index over 2,000. In many under-served urban markets—these indexes are for States—the indexes are much higher.

Four, rate-setting by ISO. Until very recently, the Insurance Services Office issued advisory rates based on analysis of historic loss data and other insurer costs. These rates were inflated by overly-generous estimates of future losses, administrative expenses, and profits, so that even the least efficient insurers could survive.

Advisory rates were then used as the basis for rate-setting by hundreds of smaller and medium-sized insurers selling about one-third of auto insurance coverages. They also allowed insurers outside the ISO to charge higher rates than more competitive markets would allow.

Five, prohibitions on agent rebating and group sales. In most States, there are laws prohibiting agents from discounting and institutions from acting as a purchasing agent for members. These prevent agents from competing on price and disallow institutions from using their clout with insurers to negotiate lower-priced policies for their members.

By prohibiting certain anticompetitive activities allowed under McCarran, S. 719 would increase competition, reduce insurer inefficiency, and restrain auto insurance prices.

First, ISO would no longer be allowed to set rates. Specifically, the legislation would prohibit trending, as well as the issuing of advisory rates. Trending is still permitted even under the new ISO scheme.

Such a prohibition would force insurers currently using ISO trending to base their rates to a much greater extent on their own expenses and less on those of the most inefficient insurers.

Second, State laws prohibiting agent rebates and group sales would probably be struck down as violations of antitrust statutes. Real competition among agents and sales through institutions to their members could lower prices significantly.

Third, concentration in auto insurance markets would likely lessen, thus enhancing competition. Modification of McCarran would challenge the cartel mind set of many insurance executives who are reluctant to vigorously compete with other insurers and are even willing to concede major markets.

Accordingly, the most important action Congress can take to provide rate relief to auto insurance buyers is to prohibit anti-competitive activities allowed under McCarran. Enactment of the legislation you introduced, Mr. Chairman, would do just this.

[The prepared statement of Mr. Brobeck follows:]

Consumer Federation of America

TESTIMONY

Of

STEPHEN BROBECK
EXECUTIVE DIRECTOR

CONSUMER FEDERATION OF AMERICA

On

REPEAL OF MCCARRAN-FERGUSON ANTITRUST IMMUNITY

Before The

SENATE JUDICIARY COMMITTEE

April 18, 1989

1424 16th Street, N.W., Suite 604 • Washington, D.C. 20036 • (202) 387-6121

Mr. Chairman and Committee members, the Consumer Federation of America is pleased for the opportunity to testify in support of the Insurance Competition Improvement Act of 1989. Passage of this legislation represents the single most important action Congress can take to increase competition and efficiency in insurance markets. Its enactment would reduce prices of insurance products, curb deceptive advertising and tie-in sales, and encourage states to eliminate other barriers to competition.

Perhaps the greatest consumer benefit offered by this legislation is increased competition and lower prices in automobile insurance markets. This is the subject that will be addressed in the following testimony.

Many areas of the country are experiencing an auto insurance crisis. Rates there are high and rising. It is not at all unusual for consumers with good driving records to be charged several thousand dollars annually. Last year, Consumer Reports published a survey of premiums charged in ten states by ten major insurers. A 41 year old couple with a 17 year old son who drive an 87 Buick and 85 LeSabre respectively would pay from $1294 to $4258 in California, from $1101 to $7610 in Georgia, from $1201 to $3311 in Michigan, and from $1341 to $6334 in Pennsylvania.

For many consumers, auto insurance is the single largest transportation expense item. For most low income households, it is simply unaffordable.

It comes as no surprise, then, to learn that most consumers believe that rates are too high. A survey conducted last year by

Best's Review found that 79% feel rates are too high. A survey undertaken earlier this year by the Consumer Federation, National Insurance Consumer Organization, and Consumers Union discovered that 72% consider rates to be "too high," while 41% feel they are "much too high". That is why, last November, California voters approved a tough, comprehensive auto insurance reform initiative. That is also why reform measures are being considered by several dozen other states.

High and escalating auto insurance rates reflect many factors including rising costs for medical care, auto repairs, and litigation. But one of the most important factors is insurer waste and inefficiency resulting from inadequate regulation and competition. The shortcomings of state regulation are well-documented. A joint study by the Professional Insurance Agents and several consumer groups, for instance, found that most insurance departments are inadequately funded and staffed.

In states regulating rates, these scarce resources reinforce the structural tendency by regulators to be overly generous to insurers at the expense of consumers when reviewing rate filings. Insurance departments are concerned primarily with insolvency, not with affordability. This concern is exaggerated when they are not able to assess adequately the financial condition of rate filers, as is so often the case.

In states with so-called "open competition," competition is often far from open. The most striking evidence of lack of competition is the huge range of insurer prices and costs. In

competitive markets, prices for equivalent products rarely range more than 50%. In auto insurance markets, as evidence already presented suggests, they often vary by 300 to 400%.

Similarly, insurer costs range widely. Selling costs, for example, range from about 5% for direct writers, to 10% for those with their own sales force like State Farm, to 15-20% for major insurers using independent agents, to as much as 50% for smaller companies using agents. As a result, it is not surprising that expense ratios vary considerably -- from 20% (USAA), to over 40% for some major companies, to over 70% for some smaller companies. Competitive markets would not tolerate such an enormous range of prices and expense ratios.

There are several barriers to competition in auto insurance markets, and the antitrust exemption conferred by the McCarran-Ferguson Act contributes to most of these. These barriers include:

1) Difficulty of consumer price comparisons. Insurance products are unavoidably complex: There are numerous coverages; the meaning of some (e.g., liability and comprehensive) is not understood by most consumers; and prices vary depending on the characteristics of the buyer, so one consumer cannot rely on the experience of others. Also, price information is not always easy to obtain: Many agents will not quote prices over the phone, and most insurance departments do not regularly distribute information on these prices.

2) Mandatory coverages. Most states require drivers to

purchase liability coverage, but most do not require insurers to sell policies. Thus, consumers correctly perceive that they are at a disadvantage in dealing with insurers. This dependence forces many to be more concerned with availability (e.g., termination) than with cost.

3) Too few sellers. Despite the existence of a couple thousand sellers nationwide, there is too much concentration in many markets. 21 states have a Herfindahl-Hirschman index of between 1000 and 1800, which indicates a moderate level of concentration, while one (Alaska) has an index above 2000. In many underserved urban markets, the indexes are even higher.

4) Rate-setting by the ISO. Until very recently, the Insurance Services Office (ISO) issued "advisory rates" based on analysis of historic loss data, and other insurer costs. These rates were inflated by overly generous estimates of future losses, administrative expenses, and profits so that even the least efficient insurers could survive. Advisory rates were used as the basis for rate-setting by hundreds of smaller and medium-sized insurers selling about one-third of auto insurance coverages. They also tended to drive up the rates of insurers who were using their own loss data and administrative costs as a basis for rate-setting. (The recent decision by ISO to cease issuing advisory rates will have a negligible effect since these rates are easily calculated from projected trends the agency continues to make available to insurers.) If those insurers charging ISO rates are considered to function as one,

concentration ratios rise substantially.

5) Prohibitions on agent rebating and group sales. In most states, there are laws prohibiting agents from discounting and institutions from acting as a purchasing agent for members. The former prevent agents from competing with one another using the price of their commissions. The latter disallow institutions such as trade unions from using their clout with insurers and access to their members to negotiate lower priced policies.

By prohibiting certain anti-competitive activities allowed under the McCarran-Ferguson Act, the Insurance Competition Improvement Act would increase competition, reduce insurer inefficiency, and restrain auto insurance prices. It would accomplish this by eliminating or reducing several barriers to competition.

First, ISO would no longer be allowed to set rates. Specifically, the legislation would prohibit trending as well as the issuing of advisory rates. (It, however, appropriately permits ISO to collect historic loss data and continue other services that do not undermine competition.) Such a prohibition would force insurers currently using ISO trending to base their rates to a much greater extent on their own expenses and less on those of the most inefficient insurers. Also, faced with greater competition, even insurers not relying on ISO trending would tend to lower their rates.

Second, state laws prohibiting agent rebates and group sales would probably be struck down as violations of anti-trust

statutes. Considering the range of insurer selling costs (5 to 50%), real competition among agents and sales through institutions to members could lower prices significantly.

Third, even though the number of sellers would probably decline, concentration in auto insurance markets would likely lessen, thus enhancing competition. By squeezing waste and inefficiency out of the industry, repeal of the antitrust exemption may well force some highly inefficient sellers out of the market, most likely through mergers with more efficient firms. The absence of these companies will be missed by no buyers. Yet, concentration in many markets would also probably lessen. Repeal of McCarran would challenge the cartel-mindset of many insurance executives who are reluctant to vigorously compete with other insurers and are even willing to concede major markets. Also, repealing anti-rebate and group sales statutes would allow major insurers currently captive of high-cost selling systems to compete effectively with such relatively low-cost, low-price insurers as State Farm in more markets.

Accordingly, the most important action Congress can take to provide rate relief to auto insurance buyers is to prohibit anti-competitive activities allowed under the McCarran-Ferguson Act. Enactment of the Insurance Competition Improvement Act would do just this.

Senator METZENBAUM. Thank you very much.

We are very pleased that one of the coauthors has joined us, Senator Simon. Senator Simon, we are very happy to hear from you.

OPENING STATEMENT OF SENATOR PAUL SIMON

Senator SIMON. Thank you, Mr. Chairman, and I apologize and I applaud you for holding the hearings. We are marking up the budget right now and it is just a minute-to-minute thing and I am going to have to get back up there.

But I think it is extremely important that we get the competitive system working more effectively in the insurance field. As I have said before, I don't think there is a justification for the wholesale exemption that now exists in the McCarran-Ferguson law.

And I would say to my friends in the insurance industry, some of whom are listening, that train is coming down the track. Sooner or later, we are going to get rid of the wholesale exemption.

I am reminded of my friends in the coal industry who were absolutely opposed to any acid rain legislation. Illinois has more coal reserves than any other State, but I said to them, we are going to get acid rain legislation. Instead of just resisting, you ought to be helping to shape this. I don't want to hurt the coal industry.

Well, now, they are trying to scramble aboard, and now it is almost too late for the coal industry to scramble aboard.

I think the insurance industry ought to be saying, let us recognize that there is no one on this committee who wants to do harm to the insurance industry. We recognize its importance to the Nation, but we also feel that the insurance industry, with the exception of sharing risk information, shouldn't have antitrust exemptions any more than two shoe stores should have antitrust exemptions.

The insurance industry, instead of resisting, ought to recognize this train is coming down the track. They ought to help to shape a constructive answer for this Nation.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you very much, Senator Simon. I am particularly pleased that you arrived. I heard a lot of different comments from the other side. I am happy to have you here.

Gentlemen, I have a few questions, but in the interest of time and because I want to be particularly fair to the last panel—and I am going to have to foreshorten it and so many of our members are not with us—I will submit some questions in writing to you, and I would guess some other members of the committee will do as well.

[The questions of Senator Kennedy follow:]

Ted Kennedy

SENATE COMMITTEE ON THE JUDICIARY
HEARING ON S. 719
APRIL 18, 1989

QUESTIONS FOR WITNESSES

1. To Dean Harvey S. Perlman (if present; otherwise to James Serota):

The Final Report of the American Bar Association Commission to Improve the Liability Insurance System recommends (with minor exceptions that are of no moment) that "State regulation of insurance rates should not exempt insurers from the antitrust laws under the state action doctrine . . . ." (Recommendation 3.1(7)). The report elaborates, "Recommendation 3.1(7) reflects the Commission position that state regulators should not be permitted to undermine the repeal of McCarran-Ferguson by permitting anticompetitive pricing activities under the state action doctrine. This recommendation does not of itself prohibit state rate regulation under appropriate circumstances." (Page 69.)

a. Having identified this problem, what do you propose as the solution? Wouldn't preemption be the natural solution?

b. Two of the Commission's members, Messrs. Stewart and Roddis, felt strongly enough about the state regulation issue to offer a separate statement. Would

you elaborate on the Commission's debates on this point and on the dissenters' point of view expressed by Messrs. Stewart and Roddis?

c. How have other sections of the ABA that have considered this problem addressed the issue?

2. To Steve Brobeck:

The intent of the bill is to maximize competition in the insurance marketplace so that consumers may enjoy all the attendant benefits. Studies conducted by the Department of Justice and others have concluded that the insurance industry, or at least the property/casualty sector of the insurance industry, which touches consumers most directly, is competitively structured.

Is there any theoretical or empirical evidence that supports the case for continued state regulation of rates established by insurers operating independently within a competitively structured industry that is subject to the antitrust laws? Assuming we succeed in repealing the McCarran-Ferguson Act's antitrust immunity, why would we continue to need state regulation of the insurance industry's rates?

3. To General Brown and/or Commissioner Gates:

The Final Report of the American Bar Association Commission to Improve the Liability Insurance System warns that the operation of the state action doctrine, in the wake of repeal of the McCarran antitrust immunity, could well undo the procompetitive benefits gained by the repeal. What the Commission appears to have been getting at is that there will be pressure from the insurance industry to get the states to regulate insurance rates rigorously enough to invoke the state action doctrine, thus "re-immunizing" the very activities that Congress intended to subject to the antitrust laws.

What is the appropriate solution to this problem? How can we address it in this legislation?

AMERICAN BAR ASSOCIATION
750 North Lake Shore Drive
Chicago, Illinois 60611
(312) 988-5000

July 14, 1989

The Honorable Howard M. Metzenbaum
Chairman
Subcommittee on Antitrust,
Monopolies and Business Rights
Committee on Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I am writing in response to a written inquiry from Senator Kennedy which you forwarded me regarding the position of the American Bar Association Commission to Improve the Liability Insurance System with respect to repeal of McCarren-Ferguson. That inquiry addressed the difference between the Commission position and the position of the dissenters, Messrs. Stewart and Roddis, on the extent to which states should be permitted to regulate insurance rates if McCarren were repealed.

This issue was the subject of very heated debate within the Commission as well as among other sections of the American Bar Association. In proposals to the House of Delegates, both the Antitrust Section and the Torts and Insurance Practice Section advocated federal preemption of state rate regulatory power if McCarren were repealed. That position was advocated by Messrs. Stewart and Roddis in their dissent to the Commission report.

The Commission majority concluded that a middle ground was both practical and appropriate. That majority drew a distinction between the power of the state to regulate and the immunity state regulation confers on private activity under the state action doctrine. If McCarren were repealed but the state action doctrine were applicable, state regulators could empower insurers to cooperate in ways that would violate, in the absence of the regulation, the antitrust laws. The Commission's recommendation is directed to prevent the state action doctrine from functioning in that way.

On the other hand, the Commission majority was unwilling to entirely preempt state rate regulation. States would continue to have the power to regulate but they could do so only in ways that did not require insurers themselves to privately act in concert.

There are two themes that run through the Commission's report that provided background to the American Bar Association House of Delegates: (1) absent clear justification to the contrary, competition is the best regulator of the liability insurance industry, and (2) absent very unusual circumstances, state regulation of insurance is to be preferred over federal regulation. The preemption of state rate regulation may advance the first but conflicts with the second theme and in this instance the Commission majority opted for permitting the states to determine whether rate regulation is appropriate.

I hope this adequately responds to Senator Kennedy's inquiry.

Sincerely,

Harvey Perlman

Harvey Perlman
Reporter, ABA Commission to Improve the
Liability Insurance Systems

cc: The Honorable Edward M. Kennedy
Robert D. Evans

1942Q

Senator METZENBAUM. I am very, very grateful to both of you, as well as Mr. Hunter, for being here and supportive. We look forward to working with you. Thank you very much.

Mr. SEROTA. Thank you, Senator.

Senator METZENBAUM. Our next panel consists of Mavis Walters, executive vice president of the Insurance Services Office, Craig Berrington, general counsel of the American Insurance Association; Erland Stevens, National Association of Casualty and Surety Agents, and Independent Insurance Agents of America; John Head, National Association of Independent Insurers; and Timothy Russell, executive vice president, National Association of Mutual Insurance Companies.

We are very happy to have all five of you here. I would say that one of your challenges may be to see that you don't keep repeating what the other person has already said, but we look forward to hearing from you.

Our time is a 5-minute period, but we might shave it just a wee bit on you just because I don't have much alternative. I didn't know as many Senators would show up as have shown up this morning and, as you well know, Senators are not exactly those who limit themselves that greatly in the time of speaking.

So I will be still and look forward to hearing from you, Ms. Walters.

STATEMENT OF A PANEL CONSISTING OF MAVIS A. WALTERS, EXECUTIVE VICE PRESIDENT, INSURANCE SERVICES OFFICE, INCORPORATED, WASHINGTON, DC; CRAIG A. BERRINGTON, GENERAL COUNSEL, AMERICAN INSURANCE ASSOCIATION, WASHINGTON, DC; ERLAND P. STEVENS, JR., CHAIRMAN, LEGISLATIVE COMMITTEE, AND MEMBER, BOARD OF DIRECTORS, NATIONAL ASSOCIATION OF CASUALTY AND SURETY AGENTS, WASHINGTON, DC; JOHN W. HEAD, CHAIRMAN, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS, WASHINGTON, DC; AND R. TIMOTHY RUSSELL, VICE CHAIRMAN, NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES, WASHINGTON, DC

Ms. WALTERS. Thank you, Mr. Chairman. I am Mavis A. Walters, executive vice president of the Insurance Services Office, ISO. You have my written statement, which I would ask be included in the record.

Senator METZENBAUM. All of the statements will be included in the record, and all of the witnesses should know that I, as well as other members, I am certain, will be sending some questions through.

Ms. WALTERS. I will confine my time this morning to discussing the operational changes which were recently approved by the ISO board of directors, some of which were discussed here already.

Senator METZENBAUM. Would you in doing so also comment on the motivational reason as to why——

Ms. WALTERS. Yes, sir.

For some time now, the political, regulatory and business environment of the property/casualty insurance industry has been changing at an accelerating pace. That environment has been

marked by expressions of concern about ISO's ratemaking process. In our view, those concerns are the result of false perceptions about the role of advisory rates in fostering competition in the property/casualty insurance business.

ISO continues to believe that providing advisory rates promotes competition, and therefore lowers prices to consumers. However, others obviously do not share that view. Some State insurance regulators, legislators at both the State as well as the Federal level, and some consumer groups have expressed doubts about the competitive benefits of our ratemaking process.

Also, we at ISO recognize that the NAIC's working group had already recommended that organizations such as ours not be allowed to file or distribute final rates. Given today's environment, and particularly the emerging attitudes of public policymakers, ISO has concluded that now is the appropriate time to act to stop providing advisory rates.

Instead, we will provide insurers with actuarial estimates of future loss payments; that is, advisory average prospective loss costs. We are taking the "rate" out of "rate bureau." That is a dramatic change in the way insurers must determine their rates in the United States.

ISO also plans to open its board of directors to public participation. Our board has already approved this plan, subject to approval by the member insurers. By opening ISO's board to noninsurance members, we hope to stimulate fresh thinking and assure the public that ISO's actions continue to be in the public's best interest.

Also, it has been ISO policy since the early 1980's that decisions with respect to statewide advisory rates have been made by ISO staff exclusively and not by insurers. The board of directors reaffirmed that policy most recently and indeed has extended it further to all rate-level-related activity and all actuarial methodology.

Effective immediately, ISO staff exclusively will be making all of those determinations.

ISO plans to introduce advisory average prospective loss costs during 1990 for all lines of insurance in all States where it is permissible under State laws and regulations. Prospective loss costs from ISO are the absolute minimum that insurers require to develop their own rates accurately and cost-effectively.

Without our actuarial analysis to project future costs on the basis of past losses, fewer insurers could enter into new markets or remain in small markets and prices would undoubtedly be higher. That is because many small and medium-sized insurers could not afford to duplicate ISO's actuarial analysis, and even larger, well-established insurers couldn't, as they do now, use ISO's analysis to enter new geographic markets and new lines of insurance with any degree of confidence in the measurement of risk potential.

The expansion of ISO's prospective loss cost procedures to all lines in all States will be accomplished in an orderly and careful manner to overcome any logistical regulatory and legal impediments and, most importantly, to avoid disruptions in the market.

Potential problem areas include the development and printing and distribution by companies of hundreds of their own manual pages and tens of thousands of commercial lines coverages and

classes, agents' need to determine multiple sets of company rate manuals in different formats, and certainly the need by regulators to review now thousands of filings where currently they may need to review only a dozen from ISO.

In recognition of the complexity of the loss cost procedures, we are committed to working with regulators in every segment of the industry to ensure a smooth transition. Special task forces will be established of agents and brokers and producers, as well as representatives of insurers, to develop implementation plans.

In conclusion, even prior to ISO's recent announcement, we believe that repeal or modification of McCarran would not enhance competition, but rather diminish it. In light of our actions, it is now even more apparent that any modification to McCarran-Ferguson would be completely unnecessary and unwarranted.

Thank you.

[The prepared statement of Ms. Walters follows:]

STATEMENT OF

MAVIS A. WALTERS

EXECUTIVE VICE PRESIDENT

INSURANCE SERVICES OFFICE, INC.

APRIL 18, 1989

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

I am Mavis A. Walters, Executive Vice President of Insurance Services Office, Inc. (ISO). ISO is a national, non-profit corporation that gathers, stores and disseminates aggregate statistical information to insurance regulators - as required by law - and to insurers for their use.

ISO develops and assists in implementing insurance policy coverage programs that help to define and cover the risks faced by policyholders. ISO also distributes industrywide advisory insurance rate information and, where appropriate, files that information with state insurance regulators.

These advisory services foster a competitive marketplace by providing information upon which individual insurers can base their independent pricing decisions and by offering economies of scale, actuarial forecasting and development of standard coverage parts. ISO is licensed to perform these services as a rating, rate service or advisory organization throughout the United States and in Puerto Rico and is subject to examination by insurance regulators.

No property/casualty insurer can be excluded from participating in ISO. Neither can an insurer be required to join ISO. Those insurers that are ISO participants may choose the ISO products or services they wish to purchase and do not have to adhere to the advisory insurance rates or standard coverage parts developed by ISO.

ISO's corporate policy of non-adherence is central to its operation and distinguishes it from the traditional rating bureaus it replaced. ISO focuses on the essential task of

developing information to assist participating insurers in making informed, intelligent and independent decisions about the insurance premiums they charge and the insurance policy forms they sell.

It is important to look at the role that ISO plays in the property/casualty insurance industry today, as contrasted with insurance rating bureaus which, in most instances, existed as cartels many years ago. Those bureaus were organized along local, regional and national lines. They specialized in either property or casualty insurance for one or more lines of coverage. In most states, insurers were required by law to belong to the bureau and use the insurance premium rates and policy forms published by the bureau. An insurer had no choice. If an insurance company was affiliated for one service offered by the bureau, it was affiliated for all of them. Effectively those bureaus came to be regarded as insurance cartels.

Today ISO's rates, rules and standard coverage parts are all advisory; that is, ISO's participating insurers have no obligation to ISO or to each other to use them. Indeed, ISO's non-adherence policy is explicitly stated in its certificate of incorporation and by-laws. ISO's essential task is the development and dissemination of information that will assist participating insurers in making informed, intelligent and independent decisions regarding the coverages they provide and the pricing decisions they make.

Unlike other industries, property/casualty insurers do not know the ultimate cost of the product they sell - the insurance policy - at the time of sale. It may take months or possibly years after the policy expires before an insurer knows its costs because, at the time of sale, losses under the insurance policy have not yet occurred.

For example, firms in most other industries are able to base their prices largely on known or controllable costs. They know at the time of sale how much they have spent on such items as labor, raw materials, equipment, transportation and the other costs of their goods and services.

Insurers, on the other hand, can only know a minor portion of their costs and must therefore predict the major part of their costs - losses and related expenses paid pursuant to the policy's terms - at the time of sale. This presents insurers with unique problems in pricing the products they sell and constitutes the essential difference between insurance and other industries.

Central to the process of insurance ratemaking is the availability of a reliable data base which provides information about losses paid or incurred on similar types of insurance coverages. As with all forms of statistical analysis, the larger and more consistent the statistical sample, the greater the probability that the predictions based on it are accurate. This "law of large numbers" means that, with a broad aggregate data base of loss experience, the analysis and prediction of expected losses would be - and usually are - more reliable.

Insurance statistics from insurers are pooled and maintained by organizations like ISO that are licensed and scrutinized by state regulators. Insurers provide ISO with data about their own premium and loss experience, which is then combined with similar information of other companies reporting data to ISO. In turn, insurers and government are provided with aggregate information derived from the pooled loss data.

ISO also develops standardized policy forms and coverage parts which enable both consumers and governments to make meaningful price and coverage comparisons among insurers. Standard coverage parts provide a base from which insurers and producers can depart, tailoring endorsements to insure unique risks or target markets.

Insurance is necessarily a complex product covering a variety of objects and activities that could potentially be damaged, destroyed or lost or could themselves cause a loss at some time in the future. With standard ISO language and coverage parts providing the baseline for decision-making, insurance consumers are more readily able to comparison shop for price, coverage and service.

More than 1400 insurers are competing in the property/casualty insurance market. If standardized coverages did not exist, consumers would be confronted with an unintelligible array of different insurance forms. Standard coverage parts permit comparison shopping by consumers without the added confusion of incomparable coverage provisions.

Insureds benefit from the clarity that the standard benchmark coverage language achieves. Standardized, readable language helps the parties to the insurance contract have a similar understanding of the coverage purchased. The purchaser can shop for the best buy with confidence, knowing that a standard minimum level of coverage is offered by almost all insurers.

Insurers also benefit from the consistency of application achieved for all their operations, including data processing, underwriting and claims handling, resulting in lower processing costs and time savings. From an insurance underwriting perspective, standard benchmark coverage language helps a huge and complex industry better cope with its day-to-day activities. Underwriters, agents and risk managers are provided with a basis on which to build a policy that meets an insured's particular needs.

"Standard" coverage parts do not mean identical coverages that cannot be customized to meet the individual policyholder's needs. For example, ISO maintains five basic coverage parts, 73 countrywide endorsements, and 118 state-specific endorsements for the homeowner's line alone. With this variety of standard coverage parts, insurers can write homeowners insurance for an apartment renter in Brooklyn who owns a large collection of art, a condo owner in Duluth who has installed a sauna and burglar alarm and wants high levels of liability coverage, or a homeowner in Palo Alto who has a swimming pool and tennis courts all using ISO coverage parts.

In the commercial lines of insurance, the availability of such standard coverage parts is even more critical than in the personal lines. Commercial insureds are far more heterogeneous, requiring coverage flexibility to allow an insurer to write a policy reflecting the individual insured's risks.

As a result, for the commercial general liability line of insurance ISO maintains 11 basic standardized coverage parts, 147 countrywide endorsements and more than 100 additional endorsements geared to specific states.

Standard coverage parts also permit the collection of comparable statistics. This provides for a more stable and reliable data base and facilitates analysis, including the more accurate forecasting of future costs for ratemaking. This also provides regulators with a valid starting point for the regulation of insurance companies' financial health.

Pursuant to state law, ISO also serves as a statistical agent. ISO develops government-approved statistical plans which facilitate the collection and compilation of reliable, usable data from many participating companies. These statistical plans are designed by ISO and filed with insurance regulators.

The ISO standard format for reporting data to regulators is based on an approved statistical plan, which is an outgrowth of standard coverage parts that also have been approved for use by insurance regulators. With a large number of insurers

conforming to a standard ISO reporting format that is reviewed regularly by regulators, state insurance departments oversee this data reporting process and have full access to the data collected.

Although large quantities of data are a prerequisite to sound insurance pricing, data collection is only the first step that must be taken to obtain information about the future costs of providing insurance coverage. Historical data can provide a good picture of past costs but give little information about future costs without additional analysis, including the use of professional judgement.

Developing meaningful pricing information from an aggregate data base involves not only actuarial formulas, but also the research skills and expertise to apply proper judgment. Data in the fine detail necessary for pricing a policy for a particular type of risk within a specific geographic territory can fluctuate greatly for even the largest insurer. Actuarial analysis - loss development, trending, etc. - of a pooled data base permits the estimation of underlying costs in spite of the random fluctuations that can appear in actual insurance losses. The more credible loss costs can then be projected into the future.

ISO's actuarial staff is among the largest in the country. ISO's actuarial services involve the preparation, review and analysis of statistical data for the purpose of developing reasonable projections of average rate level need by line of insurance, as well as for each class (a grouping of risks with

similar loss characteristics) in each geographic territory in the United States. The results are benchmark advisory rates or prospective loss costs. ISO may or may not file these with regulatory authorities in the different jurisdictions, depending upon the type of rating law or regulatory requirements. This information is also provided to participating insurers, each of whom may elect to use, modify or disregard that information depending upon their own needs or requirements.

Only a few insurers enjoy a market share large enough to permit them to develop rates based solely on their own loss experience and actuarial analysis.

Competition is so significant, market share so fragmented among the companies writing commercial insurance, and commercial risks so disparate that probably no insurer in business today could price its product credibly without access to aggregate industry experience, both historical and prospective. Such small market shares do not give individual companies enough statistical experience to generate credible statistical samples for specific risk classifications or the resources to employ large actuarial staffs. Therefore, the need for a large data base of experience for actuarial forecasting of industrywide loss costs is even more critical.

Individual company access to ISO's pooled data base makes statistically credible data available to the extent possible to any insurer that chooses to participate. The result is extraordinarily procompetitive. New insurers, small and medium-sized insurers, and even larger, well-established insurers entering new geographic areas or lines of insurance can use information gathered, analyzed and distributed by ISO to enter a new market or remain in an existing market with a reasonable degree of confidence in the measure of risk potential.

The complexity of collecting and processing large volumes of data and analyzing it for ratemaking requires considerable resources. In 1987, ISO's cost just for statistical data collection, data processing and data quality control totaled almost $40 million. If almost any of the 1400 ISO participating insurers attempted to perform these functions individually, it can reasonably be assumed that the costs would be prohibitive.

The ISO economies of scale lower individual insurer expenses, and ultimately, the premiums paid by insureds. At the same time ISO provides the most technically accurate information possible.

In order to preserve the fundamental information needed by insurers to make informed and intelligent pricing decisions, ISO recently announced some fairly dramatic changes in its operating procedures. But first, a look at events that ultimately affected the timing of these changes.

For some time now, the political, regulatory and business environment of the property/casualty insurance industry has been changing at an accelerating pace. That environment has been marked by expressions of concern about ISO's ratemaking process. In ISO's view, those concerns are the result of misperceptions about the role of advisory rates in fostering competition in the property/casualty insurance business.

While ISO continues to believe that our providing advisory rates fosters competition and lowers insurers' prices, others have expressed doubts. Individual insurance regulators, state and federal legislators, and some consumer groups have expressed differing perceptions of our ratemaking process. The advisory organizations activities working group of the National Association of Insurance Commissioners just last month recommended that organizations such as ISO not be allowed to file or distribute rates.

Given today's environment, and particularly the emerging attitudes of public-policy makers, ISO concluded now is the appropriate time to act to stop providing advisory rates. Instead, ISO will provide to insurers actuarially established estimates of future loss payments, that is, advisory average prospective loss costs. This is a dramatic change in the way insurers determine their rates in the U.S.

In addition, ISO plans to open its board of directors to public participation. Public representation on the board could include up to three non-insurer members. This change, already approved by ISO's board of directors, is subject to approval by ISO's member companies. One of the public members would be eligible to serve on ISO's executive committee.

Opening up ISO's board to non-insurer members, will stimulate fresh thinking and assure the public that ISO's actions continue to be in the public's best interest.

ISO will be prepared to introduce advisory average prospective loss costs during 1990 for all ISO lines of insurance. ISO will shift to advisory prospective loss costs in all states where that's permissible under state laws and regulations.

Advisory average prospective loss costs are estimates of future loss payments, including costs such as claims-handling and legal defense. The major difference between loss costs and advisory rates is that advisory rates include provisions for insurers' marketing and overhead expenses, as well as a provision for underwriting profit and contingencies.

Under the loss-cost procedures, ISO's participating insurance companies will have to analyze the prospective loss-cost information, determine their own prospective expense provisions, select appropriate underwriting-profit and contingency provisions, and develop their own rates. State law may then require individual insurers to file those rates with state regulators.

Our new approach is consistent with ISO's longstanding commitment to promote the affordability and availability of insurance by providing critical average-cost information that insurers can use any way they wish in making their own informed and independent decision about the prices they wish to charge.

The expansion of ISO's prospective loss-cost procedures to all ISO lines of insurance in all states will be accomplished in an orderly and careful manner to overcome any logistical, regulatory and legal impediments, and to avoid disruptions in the market.

Prospective loss costs from ISO are the absolute minimum that insurers require from us to develop their own rates accurately and cost-effectively.

Without ISO's actuarial analysis to project future costs on the basis of past losses, fewer insurers could enter new markets or remain in small markets, and prices would be higher. That's because many small and medium-sized insurers could not afford to duplicate ISO's actuarial analysis, and even larger, well-established insurers couldn't, as they do now, use ISO's analyses to enter new geographic markets and new lines of insurance with reasonable confidence in the measurement of risk potential. So insurers might not be as inclined to enter those markets.

Among the considerations in implementing ISO's new procedures are requirements by a number of states that rates be filed with state regulators. Without appropriate new procedures, regulators may need to prepare for receiving thousands of rate filings from individual companies instead of a few dozen ISO filings. In addition, regulators will need to monitor individual company rates for solvency purposes without being able to use ISO advisory rates as a benchmark.

Other potential problem areas that need to be addressed in the implementation: The development, printing and distribution by insurance companies of hundreds of their own rate-manual pages for tens of thousands of commercial lines coverages and classes, and agents' need to maintain multiple sets of company rate manuals in different formats. Today agents often are simply told by individual companies how much their prices deviate from ISO advisory rates.

It is ISO's obligation to work with insurers, producers and regulators to ensure a smooth and orderly implementation of the new procedures and to minimize the associated costs. In recognition of the complexity of the transition to loss-cost procedures, special ISO task forces of agents and brokers, and of representatives of small, medium and large insurers will be formed to help develop implementation plans.

By improving insurers' knowledge of their true costs and by introducing economies of scale, ISO confers benefits to the insuring public through lower costs. The pall that would be cast over these essential operations by the repeal or substantial modification of McCarran-Ferguson could be enough to severely curtail them. The result would be a disservice not only to insurers, large and small, but to the insuring public as a whole.

INSURANCE SERVICES OFFICE, INC.
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MAVIS A. WALTERS
EXECUTIVE VICE PRESIDENT

April 25, 1989

Honorable Joseph R. Biden
Chairman
Senate Judiciary Committee
224 Senate Dirksen Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

As a witness at the Senate Judiciary Committee's April 18 hearing on S.719, the "Insurance Competition Improvement Act of 1989", I submitted a written statement for the record. I request that the attached policy statement regarding expenses also be included in the hearing record as a supplement to my formal testimony. The attached policy statement clarifies what expense information ISO intends to provide to insurers under its expanded loss costs procedures.

In summary, ISO will no longer provide recommended factors for marketing and overhead expenses once the loss cost procedures have been expanded to all lines and all states. Under our new policy, each insurer will be required to evaluate its own expenses, project those expenses into the future and select its own particular provisions for those expense items.

Very truly yours,

Mavis A. Walters

Mavis A. Walters
Executive Vice President

maw:rd
Encl.

ISO POLICY REGARDING EXPENSES UNDER EXPANDED LOSS COST PROCEDURES

1. It is ISO's policy, when we expand our loss-cost procedures to all lines and all states, to no longer provide projections of marketing and overhead expenses. Nor will ISO recommend factors for such expenses to be used with ISO's prospective loss costs in deriving insurers' rates. Under the new policy, each insurer will be required to evaluate its own expenses, project those expenses for the future, and select its own particular provisions for those marketing and overhead-expense items.

2. We have never said that we would continue to provide such expense information with the expansion of loss-cost procedures to all lines and all states. The idea that we will do so is totally an invention of professional insurance critics. We're bewildered about how anybody got that idea in the first place. There will be no need for us to provide such expense information with the countrywide expansion of loss-cost procedures. There is such a need now--to justify the derivation of our advisory rates.

3. Under ISO's new loss-cost procedures, each individual company will need to independently analyze ISO's prospective loss costs, determine their propriety for itself, then determine its own expense and profit needs to determine a rate for itself. In some states that rate will have to be filed and approved by a regulator. The burden of justifying the appropriateness of each insurer's rate for that individual insurer is now clearly on that insurer. The same clearly goes for the responsibility to justify the appropriateness for that insurer of all the rate's components--including the expense provision. That's in contrast with the advisory-rate system, under which ISO developed, filed and distributed a rate on behalf of insurers, all of whom could use it without further justification. The move to loss costs instead of advisory rates is a <u>major change</u> in procedures.

4. ISO will provide to insurers educational information on the mathematical procedures to base rates on loss costs. But this will be information on procedure only, not direction regarding what mathematical values to use in the rate computations. ISO's educational material is something like the Internal Revenue Service's 1040 tax form--the steps for calculating the answer are laid out, but the values are left for the individual taxpayer or insurer to fill in. The difference between the tax form and the use of ISO's educational material for insurer's ratemaking is that with ISO's educational information--unlike the tax form--there are not "correct" entries and there is no foreordained right

answer--the entries and the answer are determined by each insurer, based on the values it concludes are appropriate for its own loss, expense, profit and contingency provisions.

5. In the past, when ISO provided advisory loss costs in some states and advisory rates in others, ISO provided insurers detailed support for the countrywide expense factors used in the ISO rates, because it was necessary to derive those advisory rates, where they were used. But with the introduction of loss-cost procedures on an all-states/all-lines basis, ISO's continued provision of such expense information will no longer be necessary.

Senator METZENBAUM. Thank you very much, Ms. Walters.
Mr. Berrington.

STATEMENT OF CRAIG A. BERRINGTON

Mr. BERRINGTON. Thank you, Mr. Chairman. It is a privilege being here today. I was here a year ago when we discussed the antitrust litigation which the AGs brought. I thought, in listening to Attorney General Brown this morning, as Yogi Berra would say, this is deja vu all over again.

Senator METZENBAUM. It ain't over until it is over.

Mr. BERRINGTON. I appreciate your giving us perhaps a little extra time. There is a lot to respond to. If we don't get a chance to do it, nobody will.

There are four major points I would like to make this morning. First, although McCarran-Ferguson is characterized, especially in this committee, as an antitrust issue, McCarran-Ferguson is really a power-sharing statute under which the States can regulate insurance as each State deems appropriate. There is simply no way to repeal or substantively amend McCarran-Ferguson—and make no mistake about it, your bill, Mr. Chairman, is at least a repeal—and at the same time retain the same scope of State authority.

Second, pursuant to their authority under McCarran-Ferguson, the States do, although it is not widely known here, and apparently not by Attorney General Brown—States do apply antitrust prohibitions to the insurance industry consistent with their own insurance regulatory codes.

Third, while S. 719 has been described by its advocates as compromise legislation, I believe that description to be in error. A close reading of S. 719 makes it clear that the bill, at the very best, as I said, repeals the Act and may, in fact, be reasonably read to go beyond repeal.

Fourth, I do not believe that those who advocate McCarran-Ferguson repeal in the name of open competition also advocate actually letting insurers compete without regulatory constraints on that competition, which is the very essence of State regulation.

What they really want, Mr. Chairman, is a double standard. They want repeal of McCarran-Ferguson in the name of competition, but stiff regulation to prevent competition.

Now, just a few minutes on some specifics. McCarran-Ferguson is the charter of State regulation, but McCarran-Ferguson does not dictate or direct to the States how to regulate insurance under their own regimes.

Senator Kohl asked a very good question earlier about whether McCarran-Ferguson allows insurers to get together and set rates. Let me answer that very clearly. McCarran-Ferguson allows the States to decide the rate-setting mechanism they believe best for insurance in any segment of the insurance marketplace.

The only way rates can be established in Wisconsin or Ohio or anywhere else is in accordance with the State regulatory law.

Senator METZENBAUM. Would you answer Senator Kohl's question, yes or no? Does it permit insurance companies to get together to set rates?

Mr. BERRINGTON. McCarran-Ferguson?

Senator METZENBAUM. Yes.

Mr. BERRINGTON. No. McCarran-Ferguson allows the States to decide the regulatory environment in which insurance will be undertaken.

Senator METZENBAUM. But you are not answering the question.

Mr. BERRINGTON. Let me explain.

Senator METZENBAUM. The question is, can they legally get together—you are telling me what they do, but the question I am asking you is can they legally get together to set rates, and the answer is yes.

Mr. BERRINGTON. It depends on the States. In Illinois——

Senator METZENBAUM. Forget about the States.

Mr. BERRINGTON. You can't.

Senator METZENBAUM. I am talking about just the Federal law. Under the Federal law, can they get together to regulate rates? It just takes a yes or no answer.

Mr. BERRINGTON. Mr. Chairman, if McCarran-Ferguson were repealed, under the State action doctrine, if the States wanted to have a highly prescriptive system of regulation, they could allow insurers to get together to set rates. So the answer——

Senator METZENBAUM. Mr. Berrington, is your answer yes or no?

Mr. BERRINGTON. The answer is no, McCarran-Ferguson does not allow it. McCarran-Ferguson allows the States to establish the method of rate regulation, if there is going to be rate regulation at all.

Senator METZENBAUM. Please proceed.

Mr. BERRINGTON. I think you may be interested in reading an article by Spencer Kimball, the former President of the American Bar Association and a very well-known law professor in the United States, who says exactly the same thing.

I want to add, Mr. Chairman, that—I see the yellow light is on; I have a chance to go a little bit further—that McCarran does not make any judgment as to the proper treatment of insurance under State antitrust codes.

It is a critical fact that under McCarran-Ferguson, every State has enacted antitrust prohibitions on insurers. Indeed, in 32 States, including the State of Ohio and the State of West Virginia, there is no antitrust exemption directed specifically to insurers.

In all other States where there is an exemption, it is specifically limited to those activities which are undertaken pursuant to the insurance code.

Let us look at some of the safe harbors, Mr. Chairman—the so-called safe harbors. The first one relates to loss data. This exemption is woefully inadequate even in terms of the statutory pretensions that are made for it. It does not include incurred, but unreported losses. It does not include trending, exchange of loss adjustment expense data.

Moreover, the availability of the exemption for loss data is expressly conditioned upon such information being made available to an appropriate State regulatory agency. This goes beyond what antitrust law provides for anyone else.

I see the light, but I was engaging in dialogue with you, Mr. Chairman, in response to your questions.

Senator METZENBAUM. I gave you extra time. That is the reason I didn't stop you before. I waited. The red light has been on.

Mr. BERRINGTON. If I could have just—well, okay.

Senator METZENBAUM. Finish your last sentence.

Mr. BERRINGTON. Let me just make a point that the so-called safe harbors in the bill really provide, at the very best, nothing more than would be available if the McCarran Act were repealed.

I think there can be a principled debate on whether the McCarran Act ought to be repealed. I don't believe it should, but I understand the views of others. What I have difficulty with is legislation which is styled as compromise legislation with safe harbors which doesn't really do it.

What this bill does is to repeal McCarran-Ferguson and to place insurance, even though it is regulated strongly in the States, in a position as if it were not regulated, and I think we ought to debate that issue.

Thank you very much.

Senator METZENBAUM. Thank you, Mr. Berrington. I might say to you that I respect you as a lawyer, but I think I read the law pretty well, too, and I just have to say I categorically and unequivocally disagree with you. McCarran-Ferguson does permit insurance companies to get together to regulate rates.

Now, there are other factors from the State commissioners, but the fact is McCarran-Ferguson, standing alone—and the courts have certainly confirmed this—does permit you to sit down to agree upon rates.

Mr. BERRINGTON. That just isn't true, and I don't believe there is a single court decision which says that. There was some discussion of Prop 103 which was quite interesting because——

Senator METZENBAUM. How much did you spend out there?

Mr. BERRINGTON. Of my own personal funds? [Laughter.]

Senator METZENBAUM. No, no, of the industry funds. You speak for the industry.

Mr. BERRINGTON. I don't know the figure. I know that companies spent individual funds and there was a coalition that spent money, and I suspect that the Fair Political Practices Commission in California will eventually tote up what everybody spent on all the initiatives and tell both of us what the amount was.

But the point is—and I think it illustrates the broader issue—in Prop 103, under that proposition insurers would be prohibited from engaging in activity relating to advisory rates. And if Prop 103 is upheld in the courts, then that will be the law of the land in California and insurers will be able to do only what that State statute allows them to do.

Senator METZENBAUM. Thank you, Mr. Berrington.

Mr. BERRINGTON. McCarran-Ferguson does not make that judgment. The people of California made it.

Senator METZENBAUM. Thank you.

Mr. BERRINGTON. Thank you.

[The prepared statement of Mr. Berrington follows:]

TESTIMONY
OF
CRAIG A. BERRINGTON
AMERICAN INSURANCE ASSOCIATION
ON MODIFICATION OF THE McCARRAN-FERGUSON ACT
BEFORE THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
APRIL 18, 1989

Thank you, Mr. Chairman. My name is Craig Berrington. I am General Counsel of the American Insurance Association (AIA). AIA represents major property and casualty insurance companies across the United States. I appreciate the opportunity to be here this morning to give my views on S.719 and to continue our discussion on the relationship between antitrust policy and state regulation of insurance.

There are four major points that I would like to make this morning. First, although the McCarran-Ferguson issue is generally characterized as an antitrust debate, the McCarran-Ferguson Act is essentially a power sharing statute under which the states can regulate insurance as each state deems appropriate. This was the intent of McCarran-Ferguson, when enacted in 1945 and signed by President Roosevelt. And that is how it has been consistently interpreted by the courts. There is simply no way to repeal or substantively amend McCarran-Ferguson and, at the same time, retain the same scope of state authority.

Second, pursuant to their authority under McCarran-Ferguson, the states do, in fact, apply antitrust prohibitions to the insurance industry, consistent with their own insurance regulatory codes.

Third, while S. 719 has been described by its advocates as compromise legislation which does not repeal McCarran-Ferguson, I believe that description to be in error. A close reading of S.719 makes clear that the bill -- at the very least -- repeals McCarran-Ferguson and may, in fact, be reasonably read to go beyond repeal.

Fourth, I do not believe that those who advocate McCarran-Ferguson repeal in the name of open competition also advocate actually letting insurers compete without the regulatory constraints on that competition which are a part of state regulatory systems. What they really want is a double standard: repeal of McCarran-Ferguson in the name of competition, but stiff regulation to prevent it.

NATURE OF THE McCARRAN-FERGUSON ACT

In your statement accompanying the introduction of S.719, Mr. Chairman, you characterized the McCarran-Ferguson antitrust exemption as being broad and unique--unique in the sense that no other major industry is wholly or partially exempt from antitrust law. Moreover, you stated that the exemption has been

misconstrued by the courts from the very beginning -- forty-four years of judicial error -- with the judiciary ignoring President Roosevelt's intentions. Finally, your statement said that even if McCarran-Ferguson had been properly construed it is no longer appropriate as it serves no legitimate public purpose. These are breathtaking assertions, Mr. Chairman. I disagree with each and every one of them.

In fact, there are significant antitrust exemptions for many industries and professions where Congress or a state legislature has determined that an exemption is necessary to assure some other public purpose. Some of the industries with federal antitrust exemptions that come quickly to mind are newspapers, argricultural cooperatives, motor carriers and certain professional sports, as well as the implied exemptions enjoyed by industries regulated by the federal government.

There are, indeed, broad exemptions in both federal and state law, but insurance does not have one of them. Rather, the insurance industry's exemption under McCarran-Ferguson is narrow, not broad. If there could have been any doubt about that fact when McCarran-Ferguson was first enacted, that doubt has surely been erased by three Supreme Court decisions in the last decade: Royal Drug; Pireno; and Barry. Under these Supreme Court cases insurance company practices are eligible for exemption only if each of three separate requirements is met: (1) the practices in question must constitute the "business of insurance."; (2)

those practices must be "regulated by state law"; and (3) the practices must not constitute an "agreement to boycott, coerce or intimidate or an act of boycott, coercion or intimidation."

Moreover, the courts have not made it easy for insurance companies to meet these standards because, as the Supreme Court said in Royal Drug, "it is well settled that exemptions from the antitrust laws are to be narrowly construed." 440 U.S. 205, 231 (1979). In fact, in each of the three Supreme Court cases of the last decade interpreting the McCarran-Ferguson exemption, the Supreme Court has held that the exemption did not immunize the facts that had been alleged.

This leads directly to your second misunderstanding of McCarran-Ferguson, that the scope of the exemption has been construed in a manner that is inconsistent with the intent of its framers. As authority for this proposition, your statement quoted President Roosevelt. I too have reviewed the legislative history -- and while I would not claim to speak for Mr. Roosevelt -- I have a different reading of his position and of the legislative history.

Indeed, as enacted, McCarran-Ferguson was designed to apply the antitrust laws to insurance, not to exempt insurance from them. In fact McCarran-Ferguson was officially entitled the "Insurance Antitrust Moratorium Act"--and for good reason. Section 3 of McCarran-Ferguson granted the insurance industry a

three year moratorium for enforcement of federal antitrust laws from the date of enactment -- March 10, 1945, to June 30, 1948. The purpose of the moratorium was to allow the states sufficient time to establish appropriate regulation of the industry if they chose to do so.

President Roosevelt's signing statement makes this point absolutely clear, when it says: "After the moratorium period, the antitrust laws...will be applicable in full force...except to the extent that the states have assumed the responsibility, and are effectively performing that responsibility, for...regulation." There can be little doubt that both Congress and the President perceived McCarran-Ferguson not as providing an antitrust exemption, but as mandating antitrust coverage, unless the states regulated the business.

Perhaps in recognition of this fact, Mr. Chairman, your statement accompanying introduction of S.719 contains a third argument for repeal based, I suspect, on the possibility that not everyone would believe that the courts have been so consistently wrong interpreting the law and the legislative history. This third argument is that even if McCarran-Ferguson is being properly interpreted by the courts it is no longer necessary. I strongly disagree with that view, as well. So long as Congress really wants the states to be the focus of insurance regulation -- and to have the flexibility to regulate as they individually believe appropriate -- McCarran-Ferguson must remain the law. This is

required because, at the core, McCarran-Ferguson is principally -- and pre-eminently -- an expression of federalist principles; it is a power-sharing statute. Under it, the federal government has ceded authority to the states to regulate insurance.

Thus, McCarran-Ferguson is the charter for state regulation. But, McCarran does not dictate or direct to the states about how to regulate insurance under their own regimes. And indeed, consistent with Justice Brandeis' statement that the states are the "great laboratories of federalism", there are a wide variety of state approaches to key insurance issues, such as rate regulation.

Nor does McCarran make any judgment as to the proper treatment of insurance under state antitrust codes. But it is a critical fact that under McCarran-Ferguson every state has enacted antitrust prohibitions for insurers. Indeed, in 32 states, including the District of Columbia, there is no antitrust exemption directed specifically to insurers. In all other states, where there is an exemption, it is specifically limited to those activities which are undertaken pursuant to the insurance code. And in every state, there is an Unfair Practices Act which prohibits acts which may be characterized as unfair, deceptive or discriminatory; these unfair practices acts are state versions of the Federal Trade Commission Act.

Thus, contrary to the assertion that McCarran provides a broad federal antitrust exemption, it is clear upon examination that the antitrust exemption is narrowly drawn, has been narrowly interpreted and is merely a necessary adjunct to the overriding purpose of delegating regulatory authority for insurance -- including antitrust regulatory authority -- to the states. Meaningful McCarran- Ferguson debate, therefore, must center on state regulation. Do we want it or do we not? If we want to preserve state regulation--as insurers do and as, on occasion, you have also said was your goal, Mr. Chairman -- McCarran-Ferguson is the only way to do it.

This leads directly to the second important issue: the relationship between antitrust principles, on the one hand, and regulation, on the other, for a heavily regulated industry.

RELATIONSHIP BETWEEN REPEAL OF McCARRAN-FERGUSON AND COMPETITION IN THE INSURANCE INDUSTRY

Critics of the insurance industry state that they want to repeal McCarran-Ferguson in order to make the industry "competitive." By this term, they profess to mean the policies of free and open competition embodied in federal antitrust law. But that is not what they really want at all. Under free and open market competition, as embodied in antitrust law, competitors are not required to have anyone approve the price of their product, nor does anyone serve as the public's watchdog against inadequate

or excessive pricing. Under "competition", in the antitrust sense, no one monitors a company's pricing and practices for solvency; competitors do not pay additional taxes for so-called "excess profits." Under "competition", in the antitrust sense, if one competitor goes out of business, the remaining competitors are not required to pick-up the financial tab, the way insurers are required to do in every state. Under "competition", in the antitrust sense, there are no residual market plans, where companies are required to band together to subsidize the sale of their products to those who could not otherwise afford them, there are no cancellation and nonrenewal laws or similar restrictions on a company's freedom of contract. Yet, all of these principles are included in state regulation of the insurance industry; some are the law in every state.

I have not heard that those who advocate repealing McCarran-Ferguson in order to enhance "competition" in the insurance industry also advocate repeal of these regulatory impediments to competition. Indeed, to the contrary, they want a double standard: repeal of McCarran-Ferguson in the name of competition, but stiff regulation to prevent competition.

However, if competition is interpreted as a reasonable number of competitors competing for business at a price that reflects costs, as well as a reasonable profit in a market with no significant barriers to entry or exit, then the insurance industry is highly competitive--indeed one of the most competitive industries in this country.

There are over 3500 property and casualty companies operating in the United States, and none of them has a market share in excess of 8.6% A standard measure of market concentration is the Herfindahl-Hirshman -- or HH -- index. Under the HH Index the entire market is measured, rather than simply the largest firms. The Department of Justice considers a market with an Index value of below one thousand to be unconcentrated. If the Index value is above 1800, it considers a market to be concentrated.

The HH Index for commercial liability insurance (1985) ranges from 286 (Commercial Multiperil) to 330 (Other Liability). Each figure is at least three times below the Index value of 1000 that is considered the upper limit of a competitive market. Compare the insurance industry figures to other industries and you begin to get a feel for just how low the insurance industry's HH Index value is. Steel has an Index of 650; primary aluminum, 1704; farm machinery, 1468; household cooking equipment, 1914; phonograph records and tapes, 1153, and motor vehicle parts and accessories, 1817.

Profits in the industry, although cyclical, are on the average below that of other industries. For example, from 1970 to 1985, a period that encompassed two complete underwriting cycles, the average return on net worth was 10.1% for the property/casualty insurance industry, compared to 11.8% for the group of noninsurance industries. The insurance industry fell within the bottom third of profitability ranking of all-industries.

Those who advocate McCarran-Ferguson repeal also argue, for antitrust purposes, that insurance should be treated no differently than other industries. However, the fact is, Mr. Chairman, that this is precisely how insurance is treated today. To the extent that insurers appropriately act under a regulatory code, they can not have that activity collaterally attacked by an agency or private citizen bringing an action under federal antitrust law. This is exactly the same legal principle that applies to federally regulated banks and securities businesses. The only difference is that the banks and securities industries are regulated under federal regulatory schemes, while insurers are regulated under state regulatory law. If McCarran-Ferguson did not exist, the federal antitrust laws would preempt state regulation. Actions taken by insurers under those state laws could be--and would be--attacked day-in and day-out as being inconsistent with federal antitrust law, thus placing insurers in the impossible position of being caught between state regulation and federal antitrust.

Of course, the insurance industry is the only major industry with a McCarran-type law. But this is because the other equivalent industries--banks and securities--are primarily regulated by the federal government. If insurance were regulated by the federal government--not a position I would endorse--McCarran obviously would not be necessary for insurance

either. However, all of the collective activities to which you object, Mr. Chairman, could well be authorized under the federal regulatory scheme--safe from federal antitrust attack.

The fact is that it is McCarran-Ferguson which places state regulation of insurance on an equal footing with federal regulation of federally regulated industries. It is McCarran-Ferguson which creates a level playing field on behalf of state regulators with respect to their federal counterparts and it is the repeal of McCarran-Ferguson, as S.719 would do, which would open state regulation to attack, greatly limit the regulatory authority of the states, place insurers in the impossible position of being caught between state regulation and antitrust, and encourage a torrent of litigation.

It is simply not possible to both repeal McCarran-Ferguson as S.719 would do, and retain the same freedom of state regulatory authority that is provided today. One may or may not favor Congressional action on McCarran-Ferguson, but one can not truly say that it is possible to do both. You can not.

S.719 IS A FUNCTIONAL REPEALER OF McCARRAN-FERGUSON

When S.719 was introduced, it was characterized by its supporters as a compromise measure--a bill that would modify McCarran-Ferguson by providing "safe harbors" of cooperative activity for key insurance functions. In my view, however, this

bill is no compromise. It would effectively repeal McCarran-Ferguson. It would create illusory safe harbors for collective activity that represent nothing more than activity that would be permitted under federal antitrust law if McCarran-Ferguson were repealed in a straightforward manner. Moreover, certain of these "safe harbors" would appear to be more restrictive than what is permitted under antitrust law, in that certain conditions are attached to the "safe harbors" that antitrust law would not otherwise require.

Let us examine each of the five purported safe harbors enumerated in the bill: the exchange of loss data, joint development of policy forms, joint inspection services, exchange of information on fraudulent claims, and joint underwriting.

The first "safe harbor" is for the exchange of loss data. This "exemption", however, is limited to historical data on paid claims and reserves for reported claims, which the antitrust laws would permit absent the McCarran Act and absent any safe harbor under cases like Maple Flooring Manufacturing v. U.S., 268 U.S. 563, 45 S.Ct. 578 (1925), and U.S. v. U.S. Gypsum Company, 438 U.S. 422 (1978). The bill provides no immunity for losses incurred but not reported; loss development; trending; or exchange of loss adjustment expense data. Nor is immunity furnished for other related activity that is necessary in order to make the authorized data collection meaningful and credible. This includes development of manuals, rating classification systems and statistical plans.

Moreover, the availability of the "exemption" for loss data is expressly conditioned upon such information being made available to an appropriate state regulatory agency. Individual insurers certainly have no objection to making this information available to regulators, as they do today, and would probably continue to do so in a world with or without McCarran. But, the bill seems to state that federal antitrust law should be interpreted as prohibiting all sharing of historical data unless the information is made available to an appropriate state regulatory agency. This is more than application of antitrust principles. There is no analogous requirement or condition under antitrust law, generally, with respect to other industries.

The second "safe harbor" is for policy forms. This provision essentially mirrors what the antitrust laws would probably otherwise permit in the area of product standardization, but confuses the issue even further by stating that the "exemption" would be lost upon proof that insurers agreed to use a jointly developed form, rather than used it on an independent basis. Thus, this "safe harbor" would generate litigation. Moreover, S.719 contains the additional proviso that such forms may not include "benefit levels", a provision that is ambiguous, arguably goes beyond the constraints applicable to other industries under antitrust law, and dictates to the states how they may regulate with respect to the process of policy form approval.

The third "safe harbor" would permit "research and on site inspections" of fire risks in order to prepare classifications of public fire defenses--activity which would be perfectly lawful without the McCarran-Ferguson Act or this bill.

Under the fourth "safe harbor", insurers would be permitted to exchange information to detect fraudulent claims, but only if that information were made available to an appropriate state regulatory agency which, in the area of fraud, might include many agencies other than a state insurance department. The antitrust laws, however, currently permit exchanges of this type of information without the need to invoke an exemption and without conditioning such an exchange on any further requirements.

Finally, the fifth "safe harbor", which relates to joint underwriting arrangements would "exempt" those activities only if required by law, or subject to the active supervision of the state, or if they do not "unreasonably restrain trade", in which case they would not violate the antitrust laws anyway.

Thus, these are not "safe harbors" at all if, by use of that term, you mean that activity is being protected that would violate the antitrust laws if McCarran-Ferguson were simply repealed. At best, these "safe harbors" do nothing more than restate collective activity that would be permissible under federal antitrust laws in any case. At worst -- and this is not an unreasonable reading of the language of the "safe harbors" -- the bill would actually

prohibit collective activity by insurers that is permitted under federal antitrust laws to other industries. Thus, these harbors are about as safe for the insurance business as Valdez harbor is for fish and wildlife -- and even less susceptible to clean-up.

I am also troubled, Mr. Chairman, by this bill subjecting the insurance industry to overlapping, duplicating and almost surely inconsistent regulation by the FTC under the FTC Act. Mr. Chairman, you as well as others, have stated that your overriding interest is merely to see the insurance industry treated in the same manner as other industries. In fact that is exactly what happens under current law. Banks, like insurance, are not subject to the FTC Act. Therefore, the FTC provisions in S.719, whatever their intention, would have the effect of treating insurance differently from comparable industries rather than in an equivalent manner.

Moreover, freedom from the FTC Act does not mean that insurers are free to engage in unfair or anticompetitive conduct. To the contrary, the issue is one of the appropriate regulatory forum. Just as with the antitrust exemption, the industry's FTC exemption exists solely to empower the states to regulate in the manner they see fit. In this regard, every state has passed an Unfair Trade Practices Act directed specifically to insurers that is a state equivalent of the Federal FTC Act. What possible reason can there be -- other than to increase the FTC's turf -- for extending its jurisdiction into an area so fully subject to state law.

Great things are claimed for this bill, Mr. Chairman. According to the Small Business Legislative Council, the repeal of McCarran will bring down auto, medical malpractice, general liability and workers' compensation insurance rates. It will result in insurers "insuring people the industry has historically been reluctant to insure"; the industry will base rates "on criteria different from those the industry has traditionally used" and define territories "differently than the industry has traditionally defined them." The Council also believes repeal will improve access to health care and child care and, finally, prevent future crises in property and casualty insurance. According to Consumers Union and the Consumer Federation of America McCarran-Ferguson will "lead to complete elimination of the industry's current practices of charging differential rates based on sex and race." The American Nurses Association seems to believe that McCarran has led directly to insurer's refusal to offer coverage to their members at reasonable rates. The American Bar Association believes that McCarran should be repealed because there's a bad perception of it. Citizen Action states that McCarran-Ferguson allows insurers to "withdraw coverage at will."

After listening to these statements I don't know if it is more discouraging if the people who made them actually believe their charges -- like the outrageous charge on race discrimination -- and that your bill, if enacted, would achieve all of their particular goals, or if they were merely engaging in political

hyperbole. If the former, they have not done their homework and would be sadly, even bitterly, disappointed if the bill passed and none of their goals for it were achieved. If the latter, they are merely being irresponsible and trying to mislead others. But, even snake oil, Mr. Chairman, has its limits.

It should be clear that we are dealing with very complex issues, today, at this hearing. All of us should try to avoid political hyperbole. All of us should proceed carefully. But all of us should also understand that the issues transcend narrow antitrust doctrine and must be considered in the broader context of insurance regulation, generally. Have those who advocate S.917 even considered its impact on the ability of the states to regulate for insurance company solvency. It should be of more than passing interest that at the very time this committee is looking at insurance from its antitrust perspective, at least one other Committee of Congress is examining insurer solvency issues. I suspect that among other things, that Committee will want to know whether there is sufficient data and other information available at the public level for regulators to discharge their statutory duty to monitor and regulate for insurance company solvency.

Unfortunately, much of the cooperative activity--and the data and information that such activity generates--which would be denied to insurers by S.719 is precisely the type of information that government regulators also need to make certain that insurers

do not irresponsibly price their product inadequately or on an unfairly discriminatory basis. Data with respect to losses that are incurred but not reported, loss development, trending, loss adjustment expenses, uniform rating classifications, and statistical plans--all of which must be developed in a uniform, common, and systematic manner--are all absolutely essential in order for a state insurance commissioner, or any other entity, to determine that the insurance product is adequately and fairly priced and that actual losses are not unreasonably exceeding expected losses. All of this cooperative activity would either be prohibited by S.719 -- or endangered by it -- and the prospect of 3,500 property and casualty insurers engaging in this process in an individual manner, each with its own methodology, is no substitute. Neither is the insistance that some doctrinaire version of federal antitrust law should supercede regulation of this industry by the states.

CONCLUSION

Critics of McCarran-Ferguson have characterized its repeal as a talisman. According to their view, whatever it is that one does not like about the insurance industry will be cured by McCarran repeal. Wouldn't it be nice if the problems were so simple? Wouldn't it be nice if McCarran-Ferguson repeal would solve them. But repealing McCarran-Ferguson won't solve any of them.

In the end, Mr. Chairman, you must decide whether you want the insurance industry to be a regulated by the states. If you want state regulation, McCarran-Ferguson is the umbrella for establishing and maintaining it. State regulators, and the insurers they regulate, must be assured that, just as with federally regulated industries, activity undertaken pursuant to the regulatory code will not be subject to subsequent challenge as being at variance with antitrust law.

When you introduced your bill, Mr. Chairman, you repeated a comment that you made to me the last time I had the privilege of testifying before you--that your door was always open and that you wanted to hear our concerns. I appreciated your generosity then and I appreciate it, today. I hope my comments this morning have helped further that dialogue. I'll be glad to take any questions that you or members of the Committee might have.

# # #

Senator METZENBAUM. Mr. Stevens, National Association of Casualty and Surety Agents, and Independent Insurance Agents of America. I am particularly interested in your testimony, Mr. Stevens, because it is the chair's view, as I have talked with agents in my own State, that more competition in the insurance industry would help the agents.

It is fair to say that the companies, I think, have done a pretty good job of convincing the agents to the contrary, but I would be prepared to debate that issue very up-front before the agents because I just think that the agents have been sold a bill of goods which is not really a correct one, and I think the companies can claim a lot of the credit for having achieved that objective.

Now, I will hear from you.

STATEMENT OF ERLAND P. STEVENS, JR.

Mr. STEVENS. Thank you, Mr. Chairman. My name is Ernie Stevens and I am an independent property and casualty insurance agent from Ashland, KY. I serve as chairman of the legislative committee and as a member of the board of directors of the National Association of Casualty and Surety Agents. I am pleased to appear here today on behalf of NACSA and the Independent Insurance Agents of America.

Mr. Chairman, we stand at one of those rare moments during which the industry, Congress, and State regulators can all observe the effects of change. In January, the IIAA called upon ISO to make changes that ISO has, in fact, embraced.

These events and others herald the fact that the insurance industry and its regulators are taking a new look at the nature of the ratemaking process. We welcome that inquiry because as independent insurance agents, we stand between the insurance companies and the consumer.

It is our job to make sure that our customers get the best insurance value that is available.

When the public is unhappy about rising automobile insurance rates or the unavailability of liability insurance, you can bet that we hear about it first. In the face of such questioning, we must now grapple with the future without setting off a chain reaction of events that adversely imperils the availability and affordability of insurance.

Before we address the specific provisions of S. 719, let me make two points. First, State regulation of insurance should not be displaced by Federal oversight. Ironically, perhaps, it is Proposition 103 that proves this point.

Although we disagree with the solutions adopted in California, the system of State regulation worked. The voters of California were not forced to come to Washington or to push for the passage of Federal legislation, and in the future, when California voters see the mistake they have made, Proposition 103 can be repealed without Federal intervention.

Second, the insurance industry has now recognized the need to address consumer and agent concerns. In this regard, we support the new ISO proposal. Sometimes, people ask why we, as independent insurance agents, care about McCarran-Ferguson. One simple

reason: Without the current exemption, there would be fewer insurance companies. Contraction of the market would deprive customers of choice and would threaten the ability of independent agents to help our customers choose between competing and complex insurance products.

That point brings us to the two fundamental flaws in S. 719. First, it does not permit the dissemination of prospective loss cost information. As we see it, such information should not be banned. We see no evidence that the creation of prospective loss cost data has had any adverse impact on the affordability and availability of insurance.

Indeed, my home State of Kentucky helps prove the point. ISO does not now produce final rates in Kentucky, but ISO does trend and develop loss information. In my experience, the provision of advisory services by ISO in Kentucky has been beneficial.

In Kentucky, insurance companies make their own assessment of all the factors that go into the ISO data. That is an important point. The companies do not simply add profit and expenses to the ISO data; they look at the information and evaluate it independently.

Second, the proposed legislation would implement legal change at precisely the wrong time. The recent announcement by ISO demonstrates that the insurance industry will be grappling with exactly the type of improvement sought by this bill. To that end, a significant legislative purpose has already been achieved.

Because ISO has not provided final rates in Kentucky for the past few years, I am well aware of the extra burden that is placed on independent agents by the system that ISO proposes to implement nationwide.

Instead of having an ISO manual that contains the rates of virtually all companies, we now have a separate manual for each company. That has necessarily increased the work that insurance agents must do to compare the costs and coverage of competing policies.

We object to any action that would keep independent agents from doing what we do best: selecting the most appropriate insurance package from a vast marketplace of insurance products.

At this juncture, we should all review the transition process before reaching any conclusions about the possible need for further voluntary actions, and certainly before setting those changes in legal concrete. There is simply no basis at this time for any action to change Federal law or to take any step that could lead to Federal regulation of the insurance industry.

In sum, legislation to modify McCarran-Ferguson would, in our judgment, lead only to a more concentrated and less competitive market. That would ill-serve insurance companies and insurance agents, but much more importantly, it would disserve our insurance customers.

Senator METZENBAUM. I have to cut you off; I must hear these other men.

Mr. STEVENS. Thank you.

[The prepared statement of Mr. Stevens follows:]

STATEMENT OF

ERLAND P. STEVENS, JR., CPCU
CHAIRMAN, LEGISLATIVE COMMITTEE
AND MEMBER OF THE BOARD OF DIRECTORS,
THE NATIONAL ASSOCIATION OF CASUALTY & SURETY AGENTS

ON BEHALF OF

THE NATIONAL ASSOCIATION OF CASUALTY & SURETY AGENTS

AND

THE INDEPENDENT INSURANCE AGENTS OF AMERICA, INC.

BEFORE THE

SENATE JUDICIARY COMMITTEE

Tuesday, April 18, 1989

Mr. Chairman, my name is Ernie Stevens. I am an independent property/casualty insurance agent from Ashland, Kentucky and I serve as Chairman of the Legislative Committee and a member of the Board of Directors of The National Association of Casualty & Surety Agents, a trade association representing the largest property & casualty agencies in the United States. I appear here today on behalf of NACSA and The Independent Insurance Agents of America, Inc., which is the nation's largest independent insurance sales and service organization.

We appreciate the opportunity to appear before your committee to discuss S.719, the "Insurance Competition Improvement Act of 1989."

THE CURRENT ENVIRONMENT

Mr. Chairman, we stand at one of those rare moments during which the industry, Congress and state regulators can all observe the effects of change. The passage of Proposition 103 has sparked nationwide debate. In January, the IIAA issued a policy statement focusing the attention of the insurance industry on the precise question of whether advisory groups should be distributing final rates and should be providing insurance companies with profit and expense information. In March, that IIAA policy was followed when the Advisory Organizations Working Group of the National Association of Insurance Commissioners recommended that advisory organizations not be allowed to distribute final rates. On April 3, the Insurance Services

Office, the largest rating organization, agreed voluntarily to limit its activities to the development of prospective loss data.

All of these events herald the fact that the insurance industry and its regulators are taking a new look at the nature of the rate-making process.

As independent insurance agents, we welcome inquiry into the manner in which insurance companies operate. Consumer discontent and public confusion about insurance is most often caused by lack of knowledge.

As insurance agents, we work to improve public understanding. After all, we stand between the insurance companies and the consumer. It is our job to make sure that our customers get the best insurance value that's available.

And when the public is unhappy, you can bet that we hear about it first. When automobile insurance rates rise, when small businesses see the price of liability insurance change frequently, we're asked to explain why.

That's not always easy to do, because the insurance business is complex and because, as this Committee knows, insurance can't be priced like other products and services. Insurance companies have to set prices today for costs that will be incurred tomorrow -- or long thereafter.

It is clear, therefore, that we face a period of uncertainty. The critical challenge now is to grapple with the future without setting off a chain-reaction of events that adversely imperils the adequacy and affordability of insurance.

THE SUCCESS OF STATE REGULATION

Before we address the specific provisions of S.719, it is important to recognize two principles that underly our basic views concerning the regulation of insurance. First, we must recognize at the outset that state regulation of insurance must not be displaced by federal oversight. Ironically, perhaps, it is Proposition 103 that proves this point. Although we disagree with the premises and solutions adopted in California, the system of state regulation worked. The voters of California were not forced to come to Washington or to push for the passage of federal legislation. And in the future, when California voters see the mistake they have made, Proposition 103 can be repealed without federal intervention.

Proposition 103 also proves that not all state regulation is perfect. California aside, there are states that need to spend more money on insurance regulation. But the benefits of state regulation cannot be overstated. State regulation permits the testing of new insurance products on a small scale and it permits the development of forms suited to particular problems of each state. For example, my customers in Kentucky care a great deal about the risk of mine subsidence, although that's not much of a risk in most other places.

Perhaps more importantly, state regulation is accessible to consumers and insurance agents. We don't have to come to Washington to voice a complaint. Instead, we have in place a system that is understood by everybody and that is close to the people it serves.

By contrast, the problem with federal regulation can be summed up in one word: sameness. For example, the Medicare premium is the same in California and Kentucky even though the cost of medical care is decidedly not. Federal regulation is just not well-equipped to deal with differences between states and even within a state. I doubt that my neighbors in Kentucky would like to pay higher automobile insurance premiums in order to offset the higher costs of auto repairs in New York or California. People in Ashland, Kentucky probably don't even want to pay additional premium to cover the cost of auto repairs in Louisville.

VOLUNTARY REFORM EFFORTS

Second, recent events demonstrate that the insurance industry has now recognized the need to address consumer and agent concerns. Most importantly, the Insurance Services Office has announced that it will soon stop providing full advisory rates. After a transition period, ISO will provide only advisory prospective loss costs, which are estimates of insurers' average future loss payments.

ISO will continue to provide prospective loss cost information. That activity is critically important because the exchange of both historical data and actuarial analysis by insurance companies directly contributes to a competitive insurance market. The exchange of such information permits small insurance companies to compete with giant insurance companies, who by virtue of size have access to much more statistically-reliable information.

The impact of small companies can be particularly important in securing the availability of specialized commercial lines, which may not develop enough premium income to attract the attention of larger companies. But even large companies benefit. The exchange of data allows more effective underwriting of commercial lines, where even the biggest company may have only limited experience in a particular type of insurance. And, by lessening uncertainty, the exchange of data allows all insurance companies to establish prices without including an additional risk factor based on lack of reliable information.

Moreover, the sharing of information eliminates barriers to future entry. A company that wants to write automobile insurance for the first time is aided immeasurably by the fact that it can study the loss data and actuarial analysis of the market it hopes to enter.

Sometimes people ask why we, as insurance agents, care about McCarran-Ferguson. One simple reason: Without the exception for collective activities, there would be fewer insurance companies. Contraction in the market would deprive consumers of choice and would threaten the ability of the independent agent to provide expertise and judgment to customers when they must choose between competing and complex insurance products.

It does not appear that the sponsors of S.719 necessarily reject our view. Chairman Biden, in his statement endorsing the bill, stated specifically that "Senator Metzenbaum's version of reform recognizes that rate service

organizations should continue to be allowed to disseminate prospective loss costs." Statement by Senator Joseph R. Biden, Jr. (D-Del.) on the McCarran-Ferguson Act (April 6, 1989). Unfortunately, we do not share the view that S.719 actually permits that activity.

THE PROBLEMS WITH S.719

Indeed, that point brings us to the two fundamental flaws in S.719. First, it fails to permit the dissemination of the prospective loss cost information that is critically important to the survival of small companies.

The language of S.719 creates a narrow safe harbor for only a limited type of collective rate-making activity. Section 3(b)(1) of the bill permits the collection of "historical data on paid claims or reserves for reported claims from insurers or any other source . . . ."

As written, S.719 would thus bar the use of prospective loss cost data. As we see it, loss development and trending activities should not be banned absent firm evidence that the creation of prospective loss cost data has had a discernible and adverse impact on the affordability and availability of insurance in the United States. To our knowledge, no one heretofore has produced any such evidence.

Indeed, my home state of Kentucky has allowed the use of prospective loss cost information without any competitive harm. ISO does not now produce final rates for Kentucky. But ISO does trend and develop loss information, as we believe that

it should be able to do for the nation as a whole. In my experience, the provision of advisory services by ISO in Kentucky under the current system has been wholly beneficial.

Some people apparently believe that even the distribution of prospective loss cost data can be used to fix prices. As I have said, we see no evidence of that. In Kentucky, in fact, insurance companies have made their own assessment of all of the factors that go into the data ISO provides. That's an important point. The companies have not simply added profit and expenses to the ISO data, they've looked at the ISO analysis to see whether they agree with the work ISO has done.

Second, the proposed legislation would implement legal change at precisely the wrong time. The recent announcement by ISO demonstrates that the insurance industry will be grappling with exactly the type of improvement sought by this bill. To that end, a significant legislative purpose has already been achieved.

It would be a terrible mistake to implement changes at the federal level before the effect of the ISO transition period can be fully evaluated. In fact, the transition to the new ISO system is not likely to be easy. We are told that in some states many more filings will need to be provided to state regulators. All companies, and particularly small companies, will have to learn how to use the prospective loss cost data to generate rates in a commercially reasonable manner.

And insurance agents will need to make certain that price information and policy forms continue to be generated in a way that is understandable to the public. We are, after all, the people who must translate the data from a number of insurance companies into simple, comparative information that allows us to advise our customers how they can get the best value.

Because ISO has not provided final rates in Kentucky for the past few years, I am well aware of the extra burden that is placed on independent agents by the system that ISO proposes to implement nationwide. In Kentucky, we've faced major problems. Instead of having an ISO manual that contains the rates of virtually all companies, we now have a separate manual for each company. That's necessarily increased the work that insurance agents must do to compare the costs and coverage of competing insurance policies.

In addition, software vendors in other states have provided programs that allow agents quick access to the comparative rates of their insurance companies. But such software is not available in Kentucky because the vendors simply cannot keep up with all the filings by each company. The lack of such software also increases an agent's work and costs.

I cannot emphasize too strongly that independent insurance agents must be able to compare the coverages and prices of their several companies. Unlike agents that represent only one insurer, independent agents will have to grapple with rates and forms from a number of companies. We object to any change that would keep independent agents from doing what we do best:

selecting the most appropriate insurance package from a wide marketplace of insurance products.

Thus, involvement by insurance agents and brokers is critically important to the success of ISO's new policy. ISO has already promised to form a special task force of agents and brokers to help manage the transaction to its new system. We believe that ISO should also provide for non-insurer members on its policy forms committee.

We will work aggressively to ensure the success of the new ISO plan. At the same time, we must monitor any difficulties that may arise. Under no conditions, of course, would we support any change in the ISO decision to abandon final rates and the distribution of profit and expense data.

But we cannot ignore the fact that we will be implementing a new system that directly affects thousands of insurance companies, hundreds of thousands of insurance agents and millions of insurance customers. As importantly, the change will affect state regulation. State regulators will have to consider how they can best gather sufficient information to judge the rates and guarantee the solvency of the companies they regulate. Solvency is, after all, the most important -- and pressing -- issue that insurance regulators face.

At this juncture, therefore, we should all review the transition process before reaching any conclusions about the possible need for further voluntary actions and certainly before setting those changes in legal concrete. There is simply no basis at this time for any action to change federal law or to

take any step that could lead to federal regulation of the insurance industry.

CONCLUSION

In sum, the needs of small companies, of independent insurance agents, and of state regulators quite clearly outweigh any advantage that would come from the changes mandated by S.719. Simply put, there is no reason to believe that the development of fully trended loss information has ever caused any anti-competitive impact on the market for insurance. Absent convincing proof of harm, Congress should not alter the system of data-collection and analysis that will be put in place. Legislation to modify McCarran-Ferguson would, in our judgment, lead only to a more concentrated and less competitive market. That would ill-serve insurance companies and insurance agents but, much more importantly, it would disserve our insurance customers.

Senator METZENBAUM. Gentlemen, if you just would take about 3 minutes, I don't want to cut you off. I can't come back. I apologize to you, but I don't have any choice. So please proceed, sir. Mr. John Head, National Association of Independent Insurers, and I don't mean to be slighting you by this action, sir.

STATEMENT OF JOHN W. HEAD

Mr. HEAD. Well, I would hope not because I would guess that I know more about competition in the insurance industry than most of the panelists who have spoken today.

My name is John W. Head. I am with Southern Farm Bureau Casualty Insurance Company out of Jackson, MS. I am also chairman this year of the National Association of Independent Insurers, representing 550 insurance companies.

I know you are going to enter my written statement in the record. I would like to also get entered in the record a statement by Lowell Beck, who is the president of our association.

Senator METZENBAUM. Without objection, it will be included.

[The prepared statement of Mr. Beck follows:]

STATEMENT

of

LOWELL R. BECK, PRESIDENT

NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

Allocation of Regulatory Power Under the McCarran-Ferguson Act

The McCarran-Ferguson Act allocates power between the federal government and the states regarding the reponsibility for regulation of the business of insurance. The law does not establish substantive rules of law. Therefore, repeal of or changes in McCarran will alter this power allocation arrangement, replacing the current system of state regulation of insurance with a system of dual federal and state regulation.

This change in regulatory approach is contrary to the stated goal of those who seek repeal or changes in McCarran and say they want to preserve the power of the states to regulate insurance. Such statements demonstrate either a total ignorance of the way McCarran operates or a deliberate attempt to mislead.

The McCarran Act provides insurers with a limited antitrust exemption to the Sherman, Clayton and Federal Trade Commission Acts. The act shields only the "business of insurance," which is narrowly defined by court decisions, and only when it is "regulated by state law," and specifically excludes any agreement or act of boycott, coercion or intimidation, which would be subject to full prosecution under federal law.

If the McCarran Act is repealed or changed, the business of insurance would then be subject to federal antitrust law and consumer protection regulation as embodied in the Sherman, Clayton and FTC Acts and the numerous cases and regulations interpreting those laws. So, there will be dual regulation.

Before even considering such a step, we believe it would be beneficial to consider and review the current, pervasive system of state regulation of the insurance business which currently exists. The real issue involved in the McCarran debate is over the merits of federal and state power systems. Any serious consideration of repeal or changes in the Act should focus on the ultimate shift of power that is bound to occur. This issue cannot be ignored or swept away, since common sense and common knowledge tell us that federal failures are large and many.

Attached is an NAII booklet enititled "Property-Casualty Regulation ... and how state insurance regulation works." State insurance regulation falls into eight basic categories: formation of companies, policy forms, licensing of agents and brokers, financial regulation for solvency, liquidation and rehabilitation procedures, rate regulation (and state antitrust policy), consumer protection and taxation.

:ince its enactment in 1945, the McCarran Act has fostered a highly :ompetitive and innovative insurance industry under state regulation. Changes in it would undercut the ability of states to regulate and set policy for solvency.

The so-called "safe harbors" that opponents of the act offer to prevent the industry from falling into absolute chaos are not that at all. If such a bill is enacted, there will be vast confusion about the extent and meaning of these safe harbors, and there will be a regulatory void for those seeking answers. For example, who will determine the depth and shape of these safe harbors? Who will supervise their implementation? These questions and more have not been examined, but the likely result will cost insurers millions in legal fees to find out, and no doubt will mean a steadily enlarging federal role which will produce a costly and inefficient dual federal/state system of insurance regulation.

As just one example of what might occur under dual regulation, the Federal Trade Commission has sweeping power to enforce not just federal antitrust law but consumer protection law as well. Section 5 of the FTC Act prohibits "unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce."

To demonstrate the wide range of interests the FTC could have, should it be granted authority over insurance, it is instructive to review past agency actions. During the days when the agency was criticized for overregulating industry and being a "national nanny," the FTC staff produced a document for an "Insurance Policy Session" which appears to be a blueprint for an assault on state insurance regulation. Thus, the FTC would have the power to duplicate state regulation of insurance, if it desires.

Dual federal/state regulation of insurance is inefficient, costly and unnecessary. McCarran-Ferguson should be retained, without change, and state insurance regulation preserved.

4/14/89

Mr. HEAD. Thank you very much.

The property/casualty insurance business is extremely competitive under traditional antitrust tests still applicable under McCarran-Ferguson. The industry is made up of a large number of competitors. There are virtually no entry barriers and concentration is low.

There are 3,500 companies, we have already heard this morning. The top five companies write less than 25 percent of the business. Companies with under 1 percent of the market write more than 43 percent of the business, and that, to me, is competition.

Contrary to what has been said or quoted in the press, the insurance industry is not the only industry exempt. That point, too, has been made this morning, but there is good reason for it. Insurance is a unique business. We set prices without knowing what the total cost is going to be, and we don't know until the final claim for that policy period has been settled. Sometimes they drag out for years, as you well know.

S. 719 would deprive small companies—and we are classified as a small company—of industry data upon which to base rates and lines that we don't have the experience to set rates in. If we have the experience, as we do in automobile insurance, which is our primary line, we set our own rates.

But we are called upon by our potential policyholders to write many lines of insurance that we have absolutely no experience in setting those rates. Solvency is very important to us. We have an A-plus rating and we want to maintain that rating.

So, regardless of what others may say, the recent ISO announcement that it will no longer provide adjusted advisory rates to property/casualty insurance is a major change for the industry.

My company—I don't know exactly what all it is going to mean, but I know that it is going to run up the cost of insurance because we are going to have to do things on an individual company basis that others have done for us on a collective basis. The safe harbors have been addressed.

In summary, the NAII and my company believe the provisions of S. 719 amending the McCarran-Ferguson Act amount to the same thing as outright repeal of the Act and we oppose it.

Thank you very much.

[The prepared statement of Mr. Head follows:]

Statement

of

JOHN W. HEAD

Executive Vice President

SOUTHERN FARM BUREAU CASUALTY INSURANCE COMPANY

and

Chairman

The NATIONAL ASSOCIATION of INDEPENDENT INSURERS

before the

COMMITTEE ON THE JUDICIARY

of the

UNITED STATES SENATE

Washington, D.C.

April 18, 1989

Mr. Chairman, members of the committee, the proponents of S. 719, a bill to modify the McCarran-Ferguson Act, are doing a disservice not only to themselves, but to insurance consumers when they say this legislation will reduce insurance premiums.

I can only assume they have been misled and hoodwinked by certain self-professed "consumer advocates", the trial bar, selfish banking interests, and well meaning but naive public interest groups into sponsoring legislation which they claim will reduce premiums.

On the contrary, enactment of S. 719 will mean fewer companies and less competition, higher costs to insurance providers, producers and regulators and a contraction in the marketplace, all of which will work to the disadvantage of the consumer.

This bill will do nothing to help relieve availability and affordability problems. And regardless of what others say, it will mean the unwarranted imposition of dual federal/state regulation of insurance. We most vigorously oppose enactment of S. 719.

I am John W. Head, Executive Vice President, Southern Farm Bureau Casualty Insurance Company of Jackson, Mississippi, and Chairman of the National Association of Independent Insurers.

Southern Farm Bureau Casualty Insurance Company is one of thirty Farm Bureau companies providing insurance services to Farm Bureau members throughout the United States. We operate in six southern states and have more than a million and a half policies in force. We write primarily automobile insurance and provide property coverage through mutual insurance companies with which we are affiliated.

The National Association of Independent Insurers is a non-profit trade organization of more than 550 property/casualty insurance companies of all sizes and types, stock, reciprocal and mutual companies which market insurance in a variety of ways using employees, agents or the mail. Our members write about 40 percent of the automobile insurance in the U.S., a quarter of the homeowners coverage and lesser portions of other lines.

The property/casualty insurance business is extremely competitive under traditional antitrust tests still applicable under the McCarran-Ferguson Act. The industry is made up of a large number of competitors; there are virtually no entry barriers and concentration is low. There are about 3,500 companies in the business, with new entrants coming in almost daily. Only one company comes close to having 10% of market share. The top five companies write less than 25% of the business, and the top 10% write less than 40%. Companies with under 1% of the market write more than 43% of the business.

The limited antitrust exemption provided by the McCarran-Ferguson Act permits joint collection and sharing of loss data and other essential information so that companies can make intelligent, predictive judgments about possible future losses and adequately price their insurance products to protect company solvency for policyholders.

This exemption is truly a limited one. It also has been modified many times by court decisions.

Contrary to what has been said or quoted in the press, the insurance industry is not the only industry exempt from application of the antitrust laws. In fact, there are many such exemptions in the law today, some much broader than McCarran, including exemptions for organized labor, agricultural cooperatives, soft drink bottlers, and professional sports. Congress has often granted limited antitrust exemptions where unique industries or situations exist.

S. 719 would prohibit or greatly hamper the joint collection and sharing of essential industry data. All but the very largest companies would find it impossible to compete, because they could not accurately forecast the appropriate price for their product or participate in the market efficiently.

Insurance is a unique business. Unlike other businesses, insurers never know the true cost of their product until all claims are presented and resolved. We are not like the candy store on the corner or the big chain supermarket. Insurers price before knowing costs, whereas others evaluate costs first, and then price products. Insurers must make educated projections about future losses, economic factors, legal standards and a variety of other variables, and they often must wait years to find out if they were right or wrong. Insurers must act jointly to gather every scrap of data available in order to make their estimates as educated as possible.

Certainly, S. 719 would deprive small companies like the Southern Farm Bureau of industry data upon which to base rates in many lines, and we would have two choices – to somehow rely on pricing determinations made by larger companies or to risk insolvency by setting rates without the benefit of adequate statistical supporting data. Many small companies would have to merge, with some companies opting to get out of the business altogether, thus lessening competition to the detriment of consumers.

To say that S. 719 will promote competition in the insurance industry just does not fit the facts. Proponents of the bill argue that the "state action doctrine" would assure continued state regulation of insurance. But the state action doctrine requires comprehensive state regulation before it is applicable. Thus, the industry would have to be tightly regulated with little or no price competition before the doctrine would apply. Doesn't this defeat the alleged purpose of S. 719?

Sen. Simon, a co-sponsor of S. 719, in his introductory remarks which appear in the Congressional Record on April 6, 1989, page S 3454, said, "...small insurance companies are worried that they will be unable to price their products prudently without the benefit of final advisory rates." He then goes on to say the committee must explore this potential harm.

Let me first commend Sen. Simon for recognizing this potential problem and for urging careful consideration of this small company concern.

Earlier this month, the Insurance Service Office (ISO) announced that it no longer will provide adjusted advisory rates to property/casualty insurers but instead, beginning in 1990, will only provide average prospective loss costs. The ISO action is in response to a misconception that insurers are fixing prices and is, in all candor, a response to efforts by some consumer activists and their allies on this committee to repeal, or modify the McCarran-Ferguson Act.

Regardless of what others may say, this is a major change for the industry. I cannot fully tell you what it will mean for my company. I simply do not know. I hope Sen. Simon will support me in urging the committee to at least give us a chance to go this far without jumping any further into the briar patch. Let's see how it works.

What I can tell you is that prospective loss costs, which represent future loss payments including such costs as claims handling and legal defenses, but NOT marketing and overhead expenses or underwriting profit factors, are the minimum we need at Southern Farm Bureau, in order to compete in our marketplace.

Last year, the NAII released a report of a 22-company McCarran-Ferguson Task Force which found five major implications for the industry and the public it serves, in the event of repeal or modification of the McCarran Act.

They are as follows:

(1) Regardless of how skillfully any bill was drafted or how many "safe harbors" of permissible activities were included, repeal would create an inescapable and damaging transition period.

(2) The industry would contract, resulting in fewer competitors, higher prices for the public, less choice of products, less innovation; eventually, the insurance business would fall into the hands of a few giant companies.

(3) Litigation would burgeon to test the boundaries of every safe harbor and every aspect of the business.

(4) A costly and confusing system of dual federal-state regulation would ensue, but ultimately complete federal control would supplant state regulation.

(5) Reinsurance would dry up, particularly for smaller companies, hastening their disappearance from the market.

S. 719 would create five so-called "safe-harbors" for permissible joint activities by insurers. Insurers could (1) share historical loss data; (2) jointly develop policy forms; (3) jointly inspect fire risks; (4) share fraudulent claim information and (5) jointly underwrite certain risks.

However, these "safe harbors" are so narrowly drawn that the practical effect is the same as repealing the McCarran-Ferguson Act. Virtually every one of these permissible activities would be subject to legal challenges. The uncertainty and delay caused by this litigation would result in an unwillingness on the part of insurers to write new business or to enter into new markets. The consumer would be the loser.

In summary, the NAII believes the provisions of S. 719 purporting to list permissible joint activities of insurers amounts to the same thing as outright repeal of the McCarran-Ferguson Act. We oppose its enactment for the following reasons:

The McCarran-Ferguson Act provides a limited federal antitrust exemption which is essential to a healthy, competitive insurance market and provides generally for state, rather than federal, regulation of the insurance business.

The insurance industry is extremely competitive under traditional antitrust tests, which still apply under McCarran, and is made up of thousands of competitors, with virtually no barriers to new entrants.

State regulation of insurance for solvency and consumer protection has worked well in serving consumers' interests for more than 40 years.

Elimination or substantial modification of the McCarran Act will impede or preempt State efforts to promote a highly competitive insurance marketplace within the respective states.

Elimination or substantial modification of the McCarran Act will not result in increased availability or lower the cost of insurance.

The addition of a list of narrowly drawn permissible activities to the McCarran Act is tantamount to repealing the act, and will result in increased costs and administrative burdens with no significant demonstrated consumer benefits.

Limiting the joint collection and sharing of essential industry data to include only historical loss information will cause chaos in the insurance industry, in the form of a disruptive transition period (which will be particularly devastating for small companies, many of which will cease to exist), increased litigation, higher administrative costs, more concentration and less competition in the industry, and ultimately higher consumer costs, all with no significant demonstrated consumer benefits.

Innovation in new insurance products will be stifled as protracted and expensive litigation tests the boundaries of permissible activities and their relationship to state action. As companies attempt to limit their risk exposure in such an uncertain legal climate, overall coverage and capacity may shrink.

Senator METZENBAUM. Thank you very much, Mr. Head, and I am sorry I had to foreshorten your time.

Mr. Timothy Russell, can you take about 3 minutes, sir?

STATEMENT OF R. TIMOTHY RUSSELL

Mr. RUSSELL. Yes, sir, Mr. Chairman, I will, and thank you very much for allowing me to be here today. I am the executive vice president of the Baldwin Mutual Insurance Company in Foley, AL. I am also appearing in my capacity as vice chairman of the National Association of Mutual Insurance Companies. NAMIC is a trade association of 1,286 property and casualty insurance companies. We operate through every State and county in the Nation.

We serve Main Street, USA.

Baldwin Mutual is a small insurer, offering coverage only in Alabama. We are a company owned by the consuming public. We are a consumer's organization; we are a mutual company. Like the majority of NAMIC members, we were established by consumers and continue to exist solely for the benefit of the consuming public.

We do not agree with the bill, S. 719, that the current antitrust exemption afforded the insurance industry adversely affects competition and insurance consumers. We feel that McCarran-Ferguson does indeed encourage competition in the insurance marketplace.

Because information is available from advisory organizations, we now write business statewide. We were a very small company many years ago, the oldest mutual company in Alabama. We got the information from advisory organizations and were able to grow and serve our consuming public. This is the same with most of our members of NAMIC.

If competition was not alive and well in the insurance industry, new entries would not be happening. New companies are being formed daily and new markets are being entered daily.

We serve 30,000-plus Alabama families and we would deeply be hurt by the repeal of McCarran-Ferguson. It would be an extreme hardship for us and most of our member companies.

Mr. Chairman, thank you very much for giving me these 3 minutes.

[The prepared statement of Mr. Russell follows:]

STATEMENT OF THE

NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

BEFORE THE

SENATE JUDICIARY COMMITTEE
APRIL 18, 1989

Presented by
R. Timothy Russell
Vice Chairman, NAMIC
and
Executive Vice President,
Baldwin Mutual Insurance Company

Mr. Chairman and members of the Committee . . .

My name is Tim Russell and I am Executive Vice President of the Baldwin Mutual Insurance Company headquartered in Foley, Alabama. We have been in continuous operation since 1921, making us the oldest mutual property/casualty insurance company domiciled in the state.

Baldwin Mutual started as a small assessment company and has grown to serve every town and county in our state. The company, which is owned by its policyholders, exists primarily to provide quality insurance products to some 30,000 plus Alabama families and property owners. We specialize in certain markets, especially rural areas where we write a large volume of the state's farm business, furnishing services to policyholders who might have great difficulty obtaining coverage elsewhere.

I am also appearing in my capacity as Vice Chairman of the National Association of Mutual Insurance Companies (NAMIC). NAMIC is a trade association of 1,286 property and casualty insurance companies. Members are located throughout 47 states and range in size from the largest national property/casualty insurers to the very smallest local writers. Approximately 900 members write less the $2.5 million in premiums each year, including the almost 450 companies that write annual premiums of $350,000 or less.

Remaining companies in the NAMIC membership are regional multi-line insurers (doing business in from one to perhaps 10 states at annual premium levels of up to $100 million), and national carriers whose premiums exceed $1 billion per year. These small and medium-size companies, as well as many of the national companies provide stable markets with excellent services in a competitive atmosphere. They are among the insurers who keep the free enterprise system working by offering coverage to entrepeneurs entering new fields of business.

The recent conservative underwriting and pricing environment in the commercial liability insurance market, combined with increasing auto insurance rates in large metropolitan areas, has prompted renewed charges that the McCarran-Ferguson Act's limited antitrust exemption serves to reduce competition and is, therefore, harmful to consumers. Suggested remedies, including the proposed "Insurance Competition Improvement Act" (S. 719), seek to promote price competition among insurers by limiting further that already narrow exemption with a special emphasis on restricting the process by which rates are developed.

Protecting the public through insurance coverage that is fairly priced is certainly a goal that NAMIC's members share with legislators, regulators and consumers. Mutual insurance itself, based upon the principle of providing sound security at reasonable cost, was developed in response to the various periods of insurance market constriction that have taken place during our nation's history. NAMIC companies were established by consumers and continue to exist for consumers. We must disagree, however, with the course chosen to reach that goal. We believe that S. 719 will only serve to restrict the insurance marketplace, rather than increasing the availability and affordability of insurance coverages.

NAMIC member companies are predominantly local operations, involved only in the business of insurance. These are the companies that provide stability and a competitive continuity to the property/casualty insurance industry. They are primarily personal lines companies, with heavy emphasis in the agricultural community and more than 100 years operating experience in many cases. While industry giants (including a few of our own member companies) routinely experience great fluctuations in their underwriting cycles, moving in and out of various insurance markets, the smaller companies consistently provide excellent coverage and service to their regional and local consumers.

The controversy over the insurance industry's limited antitrust exemption is, in part, an outgrowth of questions as to the effectiveness of the present system of state regulation of insurance and whether the need exists for federal involvement. Of greatest importance, however, is the effect any change in the current structure would have on the insurance marketplace and on the insurance consumer.

In order to effectively represent our members' views on these questions, NAMIC conducted a survey in 1987 to determine who, how, when and where the limited antitrust exemption was utilized and the priorities of each companies' use. Of the 1,223 U.S. companies surveyed, 545 (45%) responded. An examination of responding companies indicates that they provide a fairly representative sample of the NAMIC membership.

Our members indicate that the ability to share a wide variety of data is important to their rating process. Of those responding to our 1987 survey, 86% share data in some fashion. The most common vehicle for data sharing is through statistical organizations such as the Insurance Services Office (ISO), the American Association of Insurance

Services (AAIS) and the National Independent Statistical Service (NISS).

While S 719 would permit the collection and exchange of historical loss data, it provides no antitrust immunity for loss development and trending, research on loss prevention, or development of statistical plans and risk classifications.

The availability, for ratemaking purposes, of data on past losses (including trending) held the highest priority for survey respondents who share information - 68% of those using the data felt they could not do business without it. Another 30% could continue to operate without using past loss data but, lacking a broad base from which to develop statistically valid rate schedules, saw themselves probably forced to leave the general insurance marketplace and to restrict the variety of lines and types of exposures they insure to risks in the top tier of risk assessment or the "perfect risk."

It would be an extreme hardship, not only on my company but even more so on companies smaller than mine, if advisory organizations were prohibited from providing the collection, compilation and distribution of fully developed and fully trended loss data. Smaller insurers are heavily dependent upon the use of such data to develop a benchmark rate. That data is then used along with an analysis of each company's raw data to determine product pricing. We do not have the capability to collect the data, develop it and trend it. Small insurers do not have sophisticated data bases, statisticians, actuaries or economists. In fact, there are not enough actuaries or consulting services available to fill these needs. In addition, such services are extremely expensive. Ultimately, those costs would have to be passed on to the consumer in the form of premium increases.

By providing a greater statistical base, sharing information on fully developed loss

information allows for greater credibility in the ratemaking process. Access to industry-wide data makes it possible for insurance companies, both small and large, to develop new products, and to enter new markets and territories, which directly benefit the insurance consumer. Denying such access will lead most insurers to make pricing decisions without a realistic estimate of how they will affect company profitability and stability. There can be no doubt that, both the number and size of insurer insolvencies would increase dramatically if companies have to operate without that data.

Standard policy forms and coverages followed very closely as a vital component in pricing; 73% of the respondents use them. Seventy-one percent of those consider them absolutely essential to continued operation.

Uniform coverages and policy forms allow insurers to provide services and progress with the development of new insurance products. They also provide a source of stability, offering a general assurance that individual, insured members of the public have the same basic coverage for like risks even though they're insured by different companies. Without standard information, policyholders would have to become legal experts themselves in order to be certain that they are sufficiently protected.

Participation in activities such as reinsurance pools and joint underwriting efforts further enhances competition, according to the NAMIC survey. Forty-six percent of our respondents participate in reinsurance pools. Of those, 80% have indicated that they would be unable to do business without participation; 16% could continue to operate, but would do so on an impaired footing.

While increased capacity to write insurance is perhaps the most obvious benefit of

participating in a reinsurance pool, it is by no means the only one. Involvement in such activity allows small and medium-sized insurers to undertake joint research, risk inspection and loss prevention efforts. Doing so helps these insurers educate policyholders which, in turn, prevents losses from incurring in the first place - all of which contributes to holding the line on expenses and, ultimately, insurance costs to the consumer.

The foremost conclusion to be drawn from respondents' answers is that the present structure of state regulatory primacy, coupled with the narrow exemption from federal antitrust statues afforded by McCarran-Ferguson, does indeed encourage competition in the insurance marketplace. It has allowed smaller companies, especially, to meet existing needs and to expand to meet the future needs of their neighbors.

That is not to say, however, that this issue is one which affects only small companies. The effects of any change would be felt immediately by the medium and small insurance companies, but eventually there would also be some impact on large insurers as well. In fact, the regional and larger companies that provide many types of coverages in several states may find they are more restricted than very small companies. This is due to the fact they are expanding into new territories or additional lines of coverage with limited data of their own.

The cooperative activities insurance companies may now legally engage in make it possible for them to, among other things, compare their loss data with that of other companies to develop a more accurate picture of the potential loss they are insuring; study general industry coverages, policy forms and rating scales to develop a competitive product and set a realistic price for it; create a spread of risks among themselves within

underwriting and reinsurance pools to increase capacity. While these activities are critical to smaller operations, who otherwise could not afford the actuarial, statistical, economic and legal expertise necessary to develop the information individually, they are also important to larger companies. Having access to pertinent statistics and joint efforts enables them to expand into new nontraditional coverage areas and geographies, thus creating capacity and providing insurance protection to markets not previously served.

Our survey sheds light on the degree to which NAMIC members engage in various shared activities. Some uncertainly remains, however, as to the ultimate effect of prohibiting those activities. Most respondents would stay in business, but at a much greater cost and on a more modest scale. The greatest impact would be seen in respondents' inability to develop new products or enter new markets.

One thing is clear, respondents generally do not believe that limiting the exemption further would make insurance more readily available or affordable. There is no relationship between the Act's already limited antitrust immunity and the problems that exist in insurance today. Reducing the present scope of the McCarran-Ferguson exemption in hopes of providing an immediate solution to recent problems experienced in the insurance marketplace will not resolve the situation, but only make it worse.

Recent changes by a leading rate advisory organization are going to create enough confusion for companies like mine. It will be difficult, at best, to adjust to the ISO changes. My company will certainly experience increased costs in developing our own rate filings. To limit the industry's joint statistical activities any further would not serve the consumer. The less joint statistical gathering, the less valid final rates will be. The

ISO changes are a major adjustment for this industry. They will substantially affect the way we do business.

The ability to share information under the current regulatory system works to the benefit of the insurance consumer. By comparing loss experiences, having access to standard policy coverages and forms, and participating in reinsurance pools, respondents minimize their own costs and pass the savings to their policyholders.

I urge you to consider very carefully whether changing the McCarran-Ferguson Act will truly benefit the insuring public or will harm them. NAMIC believes that the result will be to reduce capacity, limit expansion, restrict available coverages and raise the cost of insurance to consumers.

Thank you for the opportunity to appear here today. I would be glad to respond to your questions.

Senator METZENBAUM. Thank you very much, and to each of the members of the panel, my deepest apologies because I feel that, as a matter of fact, we had the insurance commissioners who were opponents and then we had several supporters, and I would like to provide hearings to have some balance. I didn't know developments would occur as they did today.

I have questions which I will submit for the record.

[The questions of Senator Metzenbaum follow:]

JOSEPH R. BIDEN, JR., DELAWARE, CHAIRMAN
EDWARD M. KENNEDY, MASSACHUSETTS
HOWARD M. METZENBAUM, OHIO
DENNIS DeCONCINI, ARIZONA
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D.J. DUKE ENGLISH, MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510-6275

June 12, 1989

Ms. Mavis Walters
Executive Vice President
Insurance Service Offices, Inc.
1666 K Street N.W.
Washington D.C. 20036

Dear Ms. Walters:

As I indicated at the Judiciary Committee hearing on April 18, 1989, concerning legislation to modify the McCarran-Ferguson Act, I would appreciate written responses to the following questions:

1) Please list each specific activity you believe would be prohibited, or otherwise discouraged, if the antitrust laws applied to the insurance industry? In each case, explain why you reach this conclusion.

2) Please describe the methodology ISO employs in its preparation of recommended rates. In your response, include a discussion of the following issues:

a) What are the components which make up ISO's final recommended rates? How is each component estimated?
b) What factors are relevant in computing prospective loss costs?
c) Please describe "trending" and explain how trending affects ISO's advisory rates. List all factors considered in trending prospective loss costs.

3) What is unique about ISO's ability to take historical data and develop loss trends? For instance, couldn't any independent actuarial firm take the same data base use its experience and expertise to develop loss trends, which may be different from those of ISO? If your answer is no, please explain.

4) Who are ISO's competitors for developing loss cost trends? Has ISO done any studies that show that ISO does any better job of predicting losses than your competitors? If so, please provide copies of these studies.

Thank you for your attention to this matter. Your responses will be made part of the record of the hearing. If you have any questions, please contact my staff at 224-5701.

Sincerely,

Howard M. Metzenbaum
Chairman
Subcommittee on Antitrust,
Monopolies & Business Rights

cc: Ann Lavee

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1666 K STREET, N.W. SUITE 915 WASHINGTON, D.C. 20006 (202) 466-2800

MAVIS A. WALTERS
EXECUTIVE VICE PRESIDENT

July 28, 1989

The Honorable Howard M. Metzenbaum
Chairman
Subcommittee on Antitrust, Monopolies and
Business Rights
Senate Judiciary Committee
SH-308 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Metzenbaum:

Attached are responses to the questions contained in your June 12, 1989 letter. We believe that you will find this material informative and appreciate the opportunity to provide these additional comments for the record of the hearing held on April 18, 1989.

Respectfully Submitted,

Mavis A. Walters
Executive Vice President

RESPONSE TO JUNE 12, 1989 LETTER
FROM SENATOR METZENBAUM

1.) Please list each specific activity you believe would be prohibited, or otherwise discouraged, if the antitrust laws applied to the insurance industry? In each case, explain why you reach this conclusion.

A- It is no secret that ISO activities are most frequently targeted by those who would change the industry's current limited antitrust exemption even though ISO's advisory services promote competition in the property/casualty insurance industry. They provide economies of scale, and they facilitate market entry. They make insurance more affordable, more available, and more understandable. Moreover, ISO operates pursuant to long-standing corporate policies of open membership and non-adherence. ISO's own professional staff, not insurer committees, has decision-making authority concerning all rate-related matters, including actuarial methodology.

Nevertheless, since ISO is owned by insurers, and, even though they compete with each other intensely in the marketplace, that collective ownership and some of our joint research and product development has been the source of some criticism.

The question you have asked is therefore a complex one. No one can say with certainty which, if any, ISO activities would be prohibited if the antitrust laws were applied to the insurance industry; however, many of those activities might be discouraged by the "pall of uncertainty" which repeal of the current antitrust exemption would create.

This phenomenon is well-explained in the following extended excerpt from the unanimously approved Report on the Proposed Repeal of the McCarran-Ferguson Act issued on June 23, 1987, by the Committee on Insurance Law of the Association of the Bar of the City of New York, at pages 13-15.

The Pall of Legal Uncertainty

We believe repeal of the insurance industry's limited antitrust exemption will only elevate the level of legal uncertainty with which insurers must cope, resulting only in reduced capacity, availability, and competition in the marketplace. Indeed, the unique nature of the insurance industry makes it exceedingly difficult to analyze the many practices that would be subject to antitrust scrutiny if the McCarran-Ferguson Act were repealed. Most practices would be subject to a "rule of reason" analysis, to be performed by courts, on a case-by-case basis, as the practices are challenged. "Rule of reason" cases generally entail complex presentations of statistics and expert witnesses. They are among the most difficult kinds of cases for juries (and for judges) to decide. The costs of litigating them and the chances of prevailing in them are the most difficult for even the most experienced lawyers to predict.

For insurance companies, which have had little experience in dealing with the risks associated with the antitrust laws, there would undoubtedly be a tendency to stop participating even in those collective activities that would ultimately be sustained under a "rule of reason" analysis. Chief Justice Burger expressed this concern about over-deterrence in United States v. United States Gypsum Co., 438 U.S> 422 (1978):

> "With certain exceptions for conduct regarded as per se illegal because of unquestionably anti-competitive effects ... the behavior proscribed by the [Sherman] Act is often difficult to distinguish from the gray zone of socially acceptable and economically justifiable business conduct. Indeed, the type of conduct charged in the indictment in this case -- the exchange of price information among competitors -- is illustrative in this regard. The imposition of criminal liability on a corporate official, or for that matter on a corporation directly, for engaging in such conduct which only after the fact is determined to violate the statute because of anti-competitive effects, without inquiring into the intent with which it is was undertaken, holds out the distinct possibility of over-deterrence; salutary and pro-competitive conduct might be shunned by businessmen who chose to be excessively cautious in the face of uncertainty regarding possible exposure to criminal punishment for even a good-faith error of judgment."
>
> 438.U.S. at 440-41 (footnote omitted).

> In the insurance industry, the likelihood of over-deterrence is more pronounced and much more likely to cause market upheaval than in other industries. Even legislative proposals purporting to assure the continued legality of certain enumerated collective activities would trigger many years of litigation over the exact parameters of permissible conduct. Absent a showing of how such proposals would beneficially enhance competition, we must conclude that the chilling effect on essential collective activities that would result from substantial modification of the McCarran-Ferguson Act would be detrimental to the public interest.

A "pall of uncertainty" is already darkening the horizon in California, where events are amply demonstrating the complexity of the question. Last November, by a bare 51% majority, California voters were seduced by arbitrary and partially unconstitutional rate rollback provisions to pass a referendum known as Proposition 103. Proposition 103 made sweeping changes in California insurance law and made California antitrust laws applicable to the insurance industry. A couple of weeks ago, the California Attorney General's office issued for public comment a staff draft of "Antitrust Guidelines for the Insurance Industry." Those guidelines are 94 pages long, not including appendices. Even so, they are not definitive in many respects. We expect the California Attorney General to receive extensive comments from many interested parties, and we are considering the submission of comments of our own.

ISO would urge you to have your staff follow this California legal debate, and the litigation or legislation that it may evoke in the months to come. California is an important state for property/casualty insurers with more than 15% of the countrywide property/casualty premium volume. As such, California may provide a laboratory for testing many of the public policy theories espoused by those who have sought repeal or substantial modification of McCarran-Ferguson. Your subcommittee, the Congress, and we in the industry should learn a great deal from California about whether the availability and affordability of insurance improves or deteriorates when antitrust laws are made more fully applicable. For the Congress to take action on McCarran-Ferguson before the California experiment has demonstrated any public benefits would be premature at best.

2.) Please describe the methodology ISO employs in its preparation of recommended rates. In your response, include a discussion of the following issues:

a) What are the components which make up ISO's final recommended rates? How is each component estimated?

b) What factors are relevant in computing prospective loss costs?

c) Please describe "trending" and explain how trending affects ISO's advisory rates. List all factors considered in trending prospective loss costs.

A - So that our answer may be understood in the proper context, we would mention the following key points:

1. As we testified at the April 18 hearing, ISO's Board of Directors decided on March 30 to have ISO convert, beginning in 1990, from advisory rates to advisory prospective loss costs for all lines in all states, where officially permitted.

2. In more than half the states, ISO already provides advisory prospective loss costs and not advisory rates for personal automobile and homeowners insurance.

3. The National Association of Insurance Commissioners (NAIC), at its June 1989 meeting, adopted recommendations that advisory organizations should not file and distribute final rates that contain provisions for expenses (other than loss adjustment expenses) and profit, but that advisory organizations should be allowed to continue to provide data on prospective loss costs, including adjustments for trend and loss development.

Nevertheless, in response to your question, the ISO advisory rate consists of three major components:

1. average prospective loss costs: estimates of future loss payments, including loss adjustment expenses such as claims-handling and legal defense costs;

2. expense provisions: production cost, general administrative expenses, and taxes, licenses and fees;
3. an underwriting profit and contingency provision.

ISO's average prospective loss costs are derived from aggregate historical premium and loss data reported to ISO by participating insurers. Since a large portion of losses are not paid for many years after a policy has expired, historical loss data alone presents only a partial picture of the loss dollars insurers have actually realized in a given year for a particular line of insurance. For example, the first evaluation of Products Liability Bodily Injury losses after the close of the most recent policy year reflects only 3% of the losses that eventually will be paid for that policy year.

In order to estimate the total amount insurers will eventually pay for claims on policies written in recent years, actuaries apply a procedure known as loss development. Loss development is based on historical loss payment patterns and is used to adjust an immature database to reflect what ultimate losses will be for a group of policies written in the past. In other words, loss development enables insurers to estimate the total amount they will pay for claims on policies written in recent years and for which all the data are not yet final.

An aggregate historical data base, adjusted for loss development, can describe how well or how poorly an average insurer or the industry performed during a given time period for a group of policies. But even an historical data base adjusted for loss development cannot tell what costs will be for policies sold in the future.

Trend bridges the gap between the information available about costs associated with past policies and the future costs associated with new policies. Trend is an actuarial technique that examines historical patterns of claim severity (average cost per claim) and claim frequency (average number of claims per measure of exposure). By mathematically projecting measurable changes in past claim severity and frequency, actuaries determine trend factors.

Trend factors are used to adjust past loss experience to reflect future losses, i.e., those expected during the period when new rates will apply. Trend may also be applied to premiums for classes of business with an inflation sensitive exposure base to project the expected increase in premium because of inflation. Please refer to the enclosed booklet, "Using the Past to Predict the Future: Historical Data, Loss Development and Trend" for a more detailed discussion of these actuarial procedures.

However, before determining whether or not an ISO rate level adjustment is necessary the premiums reported to ISO must also be adjusted. This is done because the ISO ratemaking analysis tests the adequacy of the ISO manual rates not the rates actually charged in the marketplace. Because insurers commonly deviate from ISO advisory rates based upon their individual loss experience, expenses, and business objectives, the premiums they reported to ISO must be adjusted to the current ISO manual rate level.

This analysis is usually performed by multiplying the reported exposure units by ISO's current advisory manual rates which produces a "premium at present manual rates." This is the premium that would have been generated if insurers had charged the present ISO advisory rates.

A loss ratio (the ratio of the sum of loss and loss adjustment expenses to premiums) is then calculated by dividing the prospective loss costs by the premium at present rates. This is compared to the permissible loss ratio which indicates whether or not a rate level adjustment is necessary based on the adequacy of current manual rates to cover future expected losses. The permissible loss ratio is 100% minus the expense and profit provisions.

The ISO advisory rate also includes a provision for underwriting expenses which reflects average operating expenses that insurers can expect to incur including payments for premium taxes and agents' commissions. This expense information is based largely on the Insurance Expense Exhibit (IEE) from the Annual Statement filed by insurers, as well as aggregate expense information reported to ISO by participating insurers and individual state premium tax laws.

The underwriting profit and contingency provision of 5% traditionally included in the ISO advisory rate provides for a reasonable profit margin as well as a contingency fund should actual losses exceed expected losses. It assumes that other investment income will be earned as well.

When ISO issues advisory prospective loss costs, each individual company will need to independently analyze ISO's prospective loss costs and determine their propriety for that particular company. In addition, each insurer will be required to evaluate its own expenses, project those expenses for the future, and select its own particular provisions for those expense items by line of business and by class. Each insurer will also have to determine an appropriate profit and contingency provision. Finally, in some states rates will have to be filed and approved by a regulator. The burden of justifying the appropriateness of each insurer's rates is now on that insurer. The same clearly goes for the responsibility to justify the appropriateness for that insurer of all the rate's components--including the expense and underwriting profit and contingency provisions.

Insurance companies that receive ISO advisory rates or prospective loss costs can opt to use them, use them in part, deviate from them, or not use them at all. Individual companies' competitive strategies, marketing considerations, growth and market share priorities and other factors all influence an insurer's perspective or judgment regarding the appropriate price to charge for a given risk.

3.) What is unique about ISO's ability to take historical data and develop loss trends? For Instance, couldn't any independent actuarial firm take the same data base use its experience and expertise to develop loss trends, which may be different from those of ISO? If your answer is no, please explain.

A - ISO's loss development and trend activities give insurers an overall view of future costs rather than a view that is restricted by their own limited experience. This enables them to more effectively accomplish

the goal of spreading the risk. The public benefits from ISO's actuarial activities through lower prices and an increased number of competing insurers.

An individual company's database is generally not as useful as an aggregate database because the large database is more stable and predictive than a smaller database. The larger the insurance data base, the closer the prediction of future costs will be to actual costs. This concept is more commonly known as the law of large numbers.

ISO is a statistical agent as well as a rate service organization. ISO, therefore, has detailed knowledge about the complete underlying database, the manner in which the data are compiled, the impact of individual insurer reporting differences, and the appropriate ways to use the data.

Trend factors derived from an individual insurer's data also are not appropriate for application to an aggregate database except in specific and limited cases. The most significant considerations affecting the suitability of trend to an underlying database are the types of business written and the distribution of business by geographical area.

Claim frequency and claim severity vary materially by coverage and by state. Unless an insurer has an extremely large market share for each coverage in every state, it is highly unlikely that the insurer's data can reliably produce credible trend factors for the purpose of adjusting an aggregate data base.

Some actuarial consultants are technically capable of reviewing the ISO trend data and calculating trend factors using a variety of techniques. None of them however, would have the same level of expertise with the underlying aggregate data base that ISO actuaries possess. It is also possible that some capable consulting actuaries would calculate or select trends that are slightly different from the trends used by ISO actuaries.

However, whether the annual claim cost trend factor used in the ratemaking process is 3.9% or 3.7%, for example, is not likely to make a material difference in the final decision made by an insurer about what rates they will charge. Other marketplace factors are far more important in the overall decision-making process.

And, from a competitive standpoint, it is not the value of any particular trend factor which is of importance, but rather the rates actually charged by insurers in the marketplace. The fact is that actuaries use a variety of sophisticated techniques and methods to determine various elements in the ratemaking process and ultimately to calculate an indicated rate level change. At that stage other considerations become paramount when individual insurers are making their decisions about what rates to charge: its competitive position compared with other insurers, its overall marketing strategies, its own profit requirements and investment income expectation, any regulatory requirements regarding specific rate level factors, the desires of its own agency force and many other factors can influence a company's decision about how to change its rates.

Finally, the fact that ISO provides prospective loss cost information including trend to insurers does not preclude individual insurers, large and small, from using their own or consulting actuaries in the review process.

4.) Who are ISO's competitors for developing loss cost trends? Has ISO done any studies that show that ISO does any better job of predicting losses than your competitors? If so, please provide copies of these studies.

A - In addition to ISO, there are other statistical and/or rate service organizations that provide services to property/casualty insurers. For example, the American Association of Insurance Services (AAIS) is a statistical agent and rate service organization for some personal and commercial lines of insurance. The National Council on Compensation

Insurance (NCCI) develops and administers rating plans and systems for workers' compensation insurance. The Surety Association of America is a statistical agent and rate service organization for fidelity and surety insurers.

Some states also have their own designated statutory rating bureaus to which every insurer must belong. Two examples of these statutory bureaus are the Texas Automobile Insurance Services Office which determines private passenger and commercial automobile rates for the state of Texas. The Massachusetts Automobile Rating and Accident Prevention Bureau also determines private passenger and commercial automobile insurance rates for the state of Massachusetts.

With respect to development of loss cost trends, other ISO "competitors" are independent consulting actuaries and individual company actuarial staffs. However, even these entities benefit from ISO's aggregate data base as well as ISO's extensive and detailed loss development and trend analyses. They use the information as a tool in assisting them to determine the adequacy of their own individual information in relation to the industry as a whole.

It is obviously more efficient to allow either ISO or independent consulting actuaries to work within their own area of expertise. ISO has one of the largest actuarial staffs in the property/casualty industry - with in-depth knowledge of the data and the multiple, complex technical considerations involved in trend analyses. Consequently, ISO has the expertise to cost effectively analyze appropriate pooled information and perform the thousands of trend analyses needed to produce average prospective loss costs.

Independent actuaries, on the other hand, have expertise in the analysis of individual insurance company operations rather than aggregate, industrywide data. The absence of ISO developed trend indications would deprive all entities, including consultants, the benefit of having high quality and reliable industrywide trend factors against which to measure information based on a more limited body of data.

The compilation and actuarial analysis of aggregate industrywide insurance data in addition to individual company data would be duplicative, inefficient and costly for both independent actuaries and their clients. The property/casualty industry today maximizes its actuarial resources through licensed rate service organizations such as ISO. Companies presently use independent consultants to supplement the aggregate industry analysis provided by ISO. The current procedures also facilitate regulators oversight of the entire process.

Senator METZENBAUM. This hearing stands adjourned. Thank you for your cooperation and participation.

[Whereupon, at 12:13 p.m., the committee was adjourned.]

APPENDIX

AMERICAN ACADEMY OF ACTUARIES
JAMES J. MURPHY, M.A.A.A., Executive Vice President

May 8, 1989

The Honorable Joseph R. Biden
Chairman, Committee on the Judiciary
United States Senate
224 Dirksen Senate Office Building
Washington, DC 20510

Re: Written Statement for the Record of April 18, 1989. Hearing on S.719.

Dear Senator Biden:

I am pleased to submit copies of a statement on behalf of the American Academy of Actuaries on issues relating to the above captioned bill. This material was prepared by the Academy's Committee on Property and Liability Issues.

If you have any questions on this statement or if you need any additional information, do not hesitate to contact me. Academy representatives would be happy to meet with members of the committee or with staff, if that would be useful to you.

Respectfully submitted,

James J. Murphy

James J. Murphy

JJM:rlm

Enclosure

AMERICAN ACADEMY OF ACTUARIES

STATEMENT RELATING TO THE PROPERTY AND LIABILITY INSURANCE COMPANIES' ANTITRUST EXEMPTION

COMMITTEE ON PROPERTY AND LIABILITY ISSUES
AMERICAN ACADEMY OF ACTUARIES

MAY 8, 1989

1720 I STREET, N.W. 7TH FLOOR WASHINGTON, D.C. 20006 (202) 223-8196

This statement presents the views of the Committee on Property and Liability Issues of the American Academy of Actuaries on the antitrust exemptions afforded insurers under the McCarran-Ferguson Act.

The McCarran-Ferguson Act exempts insurers from application of the (1) Sherman, (2) Clayton, and (3) Federal Trade Commission Acts if the activity is regulated at the state level. Certain joint industry activities, including the collection of claims data, certain analyses, and the development of standard policy forms are permitted under the auspices of state regulation. Actuaries, in particular, transform this jointly collected insurance premium, exposure, and loss data into valuable information used to confidently price and monitor the performance of the insurance product.

We believe that current joint activities, such as the collection and analysis of claims data and the development and use of standard policy language, contribute to competition and encourage fair rating practices by insurers. They need to be allowed after any changes to the McCarran-Ferguson Act are completed.

Data needs of a property and liability insurance company

Insurance companies maintain sophisticated and flexible databases to respond to the information needs of their internal organizations, and to meet obligations to external organizations.

From within the organization comes the need for data available for analysis by management through which proper direction is applied to the company. All key operational areas of the company have data needs: Administration, Human Resources, Marketing, Claims, Engineering, Finance, Underwriting, and Actuarial. Actuarial needs will be the focal point of this statement.

External organizations request or require information as well. Ratemaking and statistical bureaus require very detailed data on a transactional basis. Statistics compiled on behalf of the insurance companies are supplied to state regulatory bodies to comply with state data reporting requirements. Organizations such as the Insurance Services Office and the National Council on Compensation Insurance have been authorized to analyze state statistical requirements, derive statistical plans to comply with regulation and solicit/disseminate such data on behalf of affiliated insurers.

Data are also reported to the National Association of Insurance Commissioners, committees contemplating legislation, and other regulatory and federal bodies like the IRS, SEC, Fair Access to Insurance Requirement (FAIR) plans, windstorm plans, joint underwriting associations and reinsurance facilities, the National Automobile Theft Bureau, and state guaranty funds. Organizations that rate insurance companies, such as A.M. Best Company, also have their data needs.

The "finest" level of data to be captured to meet standards imposed on insurance companies is the premium (rate) and loss associated with the single insured (exposure). When appropriately aggregated and projected, differences in the cost of providing coverage are evident. Such differentiation is desirable at a regulatory level and necessary at a competititve market level. An efficient market will exist where prices are neither knowingly inadequate, excessive, nor unfairly discriminatory for the individual insured.

The need for standardized insurance policy forms

The actuarial credibility of a body of data varies directly with its homogeneity and size. Insurance coverage data are differentiated to the greatest level of detail while remaining homogeneous. Homogeneity refers to similar characteristics with respect to the risk of loss under similar coverage terms. Each level of data detail must be of sufficient size to provide information and to draw accurate conclusions. Size and usefulness can be increased without loss of homogeneity if various insurers' similar claims and exposures are added. Repeated summations over a number of years also increases size.

Standardized insurance policy forms facilitate both homogeneity and combinability of data. As historical data accumulate, their value grow. Actuarial studies generally improve in accuracy and lead to greater confidence in decision making for the insurance risk bearer.

Consistency develops as judicial interpretations of standard contract wording become common. Over a period of time insured losses relative to contract wording become predictable. A history of consistent losses in a predictable patterns allow actuaries to project future levels of expected losses (from exposures to loss) accurately and with confidence.

The public further benefits. Competition by insurers centers around price and service once coverages are made standard. The public can conveniently compare competing quotes from various insurers.

Sophisticated commercial coverage buyers frequently obtain modified coverage under customized policy language contracts to satisfy their peculiar needs. Prices can be negotiated from standard contract bench mark prices "tuned" to the degree of coverage customization.

Even the qualified (group) self-insured is likely to supplement his coverage with commercial insurance.

State insurance departments also benefit. Their statutory and regulatory reviews are facilitated by standard coverages. They can concentrate on rates being neither inadequate, excessive, nor unfairly discriminatory knowing how the coverage applies. They can also concentrate their limited resources on equally important areas such as market practices and solvency of insurers.

Companies that employ questionable market practices and which, through examination, are noted to be pricing well below bench mark rates may become financially weak. Discovered in time, they may be rehabilitated or corrected in some other way. Price adequacy is an important tool useful to regulators in performance of their solvency testing role.

The ratemaking process-expected losses

The starting point of ratemaking is usually some quantity of statistical data, regarded as relevant (credible) to developing an indication of future experience for a coverage. Actuaries increase the predictive value of data by segmenting them into homogeneous groups, and by supplementing them with other data from other groups with similar or useful characteristics.

Competitive considerations combine with regulatory requirements to produce ever finer groupings of data by coverage, location, classification, subclassification, etc. Any time a grouping or class is known to be somewhat heterogeneous, attempts are made to subclassify and eliminate subsidies.

Before the historical data can produce useable rates, they must be adjusted to reflect conditions expected to prevail while the rates are in effect. Past and prospective changes in claims costs, frequencies of loss, exposure levels, and other experience variables should be reflected in trend adjustments. Judgments are required. Bureaus employ actuaries and other professionals to make these projections. Smaller companies get the benefit of these expert judgments.

Since it is unlikely that all losses from the historical experience data base are settled, an estimate of their ultimate value must be made. This estimate must include a provision for loss development on the case reserves outstanding and a provision for losses incurred but not reported (similarly for their handling expenses). The bureau actuary and others again exercise expert judgment in the ratemaking process.

Future expected losses and loss adjustment expenses are related to appropriate exposure bases for the insured to determine an expected loss cost component of the rate.

Determining proper expense provisions

A rate must also provide for insurer overhead items and an appropriate underwriting profit.

The profit component is subject to considerable debate. Theory aside, the short and long term marketplaces reward each company with a profit or loss dependent on its specific revenue, including investment income, less losses, adjustment expenses and overhead.

To the extent future expected losses can be projected accurately and with confidence, the capacity for writing insurance is increased and its pricing made more competitive. Conversely, as the risk of adverse deviation from expected losses increases, insurers hedge by reducing available insurance and conservatively adding to their required profit margin, thus leading to higher prices.

Expenses or overhead are a major portion of the insurance premium composing approximately one-quarter to one-third of the total premium charge. They include commissions; other acquisition expenses; general expenses; and taxes, licenses, and fees. In comparison to the loss cost component, very little detail data are available for expenses at an industry or aggregate level. Compilation of expense data conform to New York Insurance Department Regulation #30, thus facilitating comparisons among companies. Furthermore, rating bureaus use the expense data in establishing rates.

Bureaus aggregate expense to premium information to determine average expense provisions. They are mostly expressed as a percentage load. This procedure gives companies the opportunity to deviate from average loadings on the basis of their specific expense ratios, or to flatten expenses for larger premium accounts, or to adopt a fixed expense/variable expense format for themselves. Competition in controlling and minimizing expenses is keen.

In states which have competitive pricing laws, the rating bureaus will only file advisory loss cost components and each company will add its own expense and profit component. This filing requirement creates an additional cost to the insurer and regulator.

Competition in the current regulatory environment

Individual state regulatory authorities normally have responsibility for approving appropriate rate levels for insurance companies. Non-competitive rate levels are disapproved if deemed excessive.

The most basic way that insurers compete is by filing independent rates or deviated rates from the bureaus' advisory rates. Large insurers with credible experience of their own file independently. Other insurers do not always wish to adhere to bureau filed rates because of different expense components, different profit expectations, and different anticipated levels of loss experience due to underwriting selectivity.

The use of schedule, experience, and retrospective rating plans also assures that competition will exist in the current environment. Schedule rating permits each insured's rate to be modified to reflect its own particular risk characteristics. Experience and retrospective rating plans use an insured's own loss experience to the extent it is credible as a basis for determining the final premium. These plans differ among companies, and the wide variety of possible choices assures that policies will be competitively priced.

Casualty insurance policies also have borrowed the concept of participating policies from the life insurance industry. Under these plans, excess earnings are returned to an insured in the form of dividends.

Although insurance companies generally provide uniform coverages and bureaus add underlying experience, each company is an independent decision making organization. Like any other company, it seeks to reach its financial goals and enhance market position. Companies continue to aggressively compete for business as long as they perceive it can be written with sufficient profit.

In a truly anti-competitive environment the number of companies operating is reduced and the size of the surviving firms becomes quite large. The A.M. Best Company estimates that there are over 2,100 property and liability companies operating in the U.S. today, and the number is growing.

Benefits to the insuring public

Current regulation of insurance data reporting and their processing into rates benefit the public in numerous ways. Any change poses both threats and opportunities to improve current benefits.

Current uniform statistical plans permit analysts to evaluate the experience of insureds in fine classification detail. Experience for individual classes would not be sufficiently credible for ratemaking purposes without the accumulated experience of many companies. Accumulated experience is most valuable when it comes from standard language policy forms.

This introduces an economy of scale into the ratemaking and regulatory process. If each interested party had to decide on the level of experience (by form of coverage) necessary for its own ratemaking needs, then resource expenditures would be much greater.

Having bench mark detailed rate levels permit regulators to concentrate their efforts elsewhere in service to the public. Other vital roles regulators perform include market practice surveillance and solvency testing.

Bench mark rates also permit new companies to enter the insurance enterprise or established companies to expand into unfamiliar areas - such as states, territories, and new lines of business or classes of business. Without such substantial public data innovation would be jeopardized. Capacity would be highly unpredictable. Pricing would be more defensive.

Benefits are realized in both personal lines of business and commercial/self-insured lines.

Will Change Reduce Rates?

Many proponents of change to the current insurance industry antitrust exemption provided by the McCarran-Ferguson Act publicly advocate change as a means to reduce private passenger automobile rates. Is this a logical result? The use of a rating bureau rate or future loss cost as a bench mark for overall rate level is not inhibiting. The rates of several large independent filers are viewed as the competitive rate levels in today's competitive marketplaces. Change to the antitrust exemption prohibiting or restricting rate bureau activity would not, therefore, reduce overall rate levels. Bureau calculated relativities between classifications are relied upon more heavily by the insurance industry than overall rate levels, but traditionally changes to these relativities are implemented at no change to overall rates. Merely altering the methods by which the insurance industry calculates and determines rates will have little or no effect on those rates. Meaningful long term rate reductions can only take place when the basic insurance equation is impacted by factors such as favorable changes to laws, implementation of safety features (e.g. seatbelts, reduced expressway speeds), etc. such that less loss dollars are expended so less premiums are indicated.

Appendix

The American Academy of Actuaries was formed in 1965 to serve as the voice of all qualified actuaries in the United States to federal and state governments, other professions, and the public at large. Over 8,000 actuaries in all areas of specialization belong to the Academy. These members are employed by insurance companies, consulting actuarial firms, government, academic institutions, and a growing number of industries.

Membership on the Committee on Property and Liability Issues preparing these comments has been drawn from a wide range of interests and perspectives so as to give a broad range of views on the matters in this report. As with many other professional organizations, the structure of the Academy and the timing required in responding to various public issues places the responsibility of preparing comments on such issues on its committees, on the assumption that they are representative generally of the Academy's membership.

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STATEMENT

OF

THE AMERICAN COUNCIL OF LIFE INSURANCE

and

THE HEALTH INSURANCE ASSOCIATION OF AMERICA

before the

COMMITTEE ON THE JUDICIARY

of the

UNITED STATES SENATE

on

S.719, The Insurance Competition Improvement Act of 1989

May 9, 1989

STATEMENT

The American Council of Life Insurance and the Health Insurance Association of America are the principal trade associations for the life and health insurance industry. Together their members represent the overwhelming majority of the assets and insurance in force of the nation's life and health insurance companies. We are pleased to be able to comment on S.719, legislation to modify the antitrust exemption for the insurance industry.

At the outset we must say that we are adamantly and irrevocably opposed to S.719. It's enactment would achieve none of the stated objectives; it is based on a simplistic and factually incorrect assessment of the operation of the insurance marketplace, and it will, in the long run, lead to less competition, higher prices and reduced availability of insurance. In addition, it would lead to duplicate or conflicting regulation at the hands of state and federal authorities.

What Has Stimulated This Attack on McCarran?

The interest in modifying the McCarran Act was caused primarily by availability and affordability problems in commercial liability insurance several years ago. As everyone must by now be aware, these problems were caused, in part, not by a lack of competition but by overzealous competition. Even so, it is important to note that time and changing economic conditions have largely eliminated commercial liability insurance availability and affordability pressures, so that S.719, even in the best light, is really a solution to a non-existent problem. Moreover, commercial liability insurance represents just 2% of the total insurance market, yet the provisions of S.719 would affect 100% of the insurance market, including the life and health insurance industries where there has not been even a suggestion that price-fixing or other competitive problems exist.

How S.719 Would Affect the Life and Health Insurance Industry

Litigation Increase - Since life and health insurers do not use rating bureaus as an aid in arriving at policy rates, we do not have the same operational problems as our brethren in the property/casualty industry with respect to the effect of S.719 on developing fair and adequate prices.

On the other hand it is clear that repeal of the limited antitrust immunity would expose all joint insurer activity, not specifically exempted, to antitrust challenge. In our view, the lack of legal precedent in the insurance area would encourage the plaintiffs' bar to litigate extensively to test the limits of permissible joint insurance activity.

This threat of litigation would cause large and small companies alike to withdraw from activities which might otherwise have significant consumer benefits including voluntary efforts like that involved in the Baldwin-United insolvency work-out. In addition, where litigation was initiated, the costs would inevitably have to be passed along to consumers. The result would be reduced availability, higher prices and less stability in insurance markets.

"Exempted" Activities- It has been suggested that the loss of the antitrust proviso is compensated for by the inclusion in the bill of specific exemptions which purportedly shield essential joint activities from antitrust challenge. In fact, these so-called "exemptions" only apply to conduct that would not violate the antitrust laws in the first place. Moreover, even if meaningful exemptions could be devised protecting currently essential activities, the statute could not address activities that might be essential in the future. If the proviso were repealed, legislative action would become necessary to allow for any new activities. A timely response by industry for the public good would become impossible.

For instance, over the last several years, health insurers have instituted a variety of mechanisms aimed at controlling the rising costs of medical services. Some of these have involved activities such as seeking implementation of hospital budget approval laws, professional standards review, and provider education. A narrowing of the proviso which did not specifically contemplate this activity, or future activities not yet developed, could inhibit insurer initiatives to help to find answers to the national problem of rising health care costs. Such a result would not be in the public interest.

Disruption of the body of insurance law based on state regulation also increases the potential for unnecessary and costly litigation as noted previously. Any new statute would be subject to a vast array of varying interpretations by antitrust enforcement agencies, the courts and the private bar.

State Action Defense- It has been suggested that, notwithstanding the application of the antitrust laws to the business of insurance, the so-called "state action" doctrine would be sufficient to allow the states to continue their role as the industry's primary regulators and permit some types of beneficial co-operative conduct by insurers which might otherwise be questionable under the antitrust laws.

Current judicial interpretation of the "state-action" immunity requires (1) a clearly articulated state policy to grant antitrust immunity to an activity and (2) active state supervision of the activity. Would each of the 50 states go through the laborious process of re-defining all the insurance activities for which they intended an insurance antitrust immunity to apply? Would all the states act in parallel fashion? Could it be done in a timely manner? Would the level of state supervision of an activity satisfy judicial interpretations of the "actively supervised" test? Would these interpretations vary from state to state and activity to activity?

Insurers believe it is inconceivable that such a process would occur with the necessary degree of uniformity to assure the general legality of any given activity. A broad spectrum of state responses would be far more likely. Some states, in an effort to conclusively oust federal antitrust jurisdiction, would overregulate the business, stifling competition and increasing costs. Other states might define permissible or mandatory joint activities but exercise less than the requisite level of supervision (raising the prospect that an insurer could be subject to a federal treble damage action for engaging in activities compelled by state law). Still other states might not be inclined to re-visit the insurance code at all, simply relying on existing state statutory language.

Uncertainty and inequity would be the principal products of such a process. Even where states adopted identical approaches to particular activities, they could be subject to vastly different judicial interpretations. Insurers doing business nationwide would likely find a particular activity to be perfectly legal under the federal antitrust statutes when conducted in some states and a violation of those same statues when conducted in other states. In sum, the state action doctrine is an unreliable shield for desireable joint activity conducted in multiple states.

FTC Trade Practice Jurisdiction - We are often asked why the FTC should be prevented from exercising the same type of regulatory authority over insurance that it may exercise over virtually every other industry. The fact is, of course, that the FTC does not have general regulatory authority over a number of significant industries including banking, savings & loans, securities, communications, common carriers and public utilities. All of these industries are shielded from full FTC scrutiny because they share a common characteristic, they are all subject to extensive regulation at the hands of other state or federal agencies. This is no less true of insurance which is comprehensively regulated at the state level.

Those who favor removing the insurance antitrust exemption have concentrated almost exclusively on the dubious notion that competition or availability would be enhanced thereby. Nowhere has the assertion been made that insurance trade regulation at the state level is inadequate or needs to be replaced by or overlaid with FTC regulation, and yet that is what would happen were the FTC Act to be generally applied to the business of insurance.

The involvement of the FTC in insurance regulation is unnecessary. In the three year moratorium period following the enactment of McCarran, the states were given the opportunity to enact legislation regulating insurance trade practices to an equal or greater degree than was possible under the language of the FTC Act and in so doing, preempt the FTC for trade regulation purposes. Virtually all the states responded by passing Unfair Trade Practice Acts for insurance in which the operative language was identical or parallel to that contained in Section 5 of the FTC Act. Since that time, using such language as a foundation, the states have developed further specific regulations to deal with difficult insurance issues as they have arisen. In 1972, these Unfair Trade Practice Acts were substantially strengthened and now provide protection for consumers much beyond that which would be possible under FTC Act language alone. (For example, in addition to prohibitions against unfair methods of competition and unfair or deceptive acts and practices (FTC Act section 5 language), these unfair trade practices acts contain specific prohibitions against such things as misrepresentations of benefits, conditions, terms; misrepresentations for the purpose of inducing lapse, forfeiture, exchange, conversion or surrender; false advertising, defamation, boycott, coercion, intimidation, unfair discrimination, etc.).

Because different state insurance departments may initially take different approaches to solving the same problem, there is the opportunity (which would not exist under all-you-eggs-in-one-basket federal regulation) to see in a relatively short period of time the results of a broad range of regulatory experiments. Typically, those which prove the most successful become universally adopted.

In a similar way, the experiences of different state insurance departments are drawn on by the National Association of Insurance Commissioners (NAIC) in the development of the various Model Insurance Acts. In the life and health insurance field these Model Acts, which generally have received wide acceptance, cover such topics as nonforfeiture, valuation, holding companies, cost disclosure, mergers, policy language simplification, blindness, sex discrimination, claim settlement practices, policy loan interest rates, group insurance and replacements.

In order to help facilitate the enforcement of unfair trade practice and other model statutes, the NAIC has developed a market conduct surveillance guide which details the procedures to be followed in conducting an extensive examination of insurance practices in four key areas: 1) advertising and sales; 2) underwriting; 3) rating; and 4) claims. This guide has been adopted by many state insurance departments to aid in their periodic insurance examinations.

In short, state regulation is flexible, responsive and comprehensive. Those who favor the FTC's involvement in insurance trade regulation, will assert that state regulation has fallen short in some areas. As discussed earlier, no regulatory system is without faults, and there is always room for improvement. The key question is whether the states act to correct problems as they become apparent.

Where is the Support for McCarran Repeal?

The sponsors of S.719 make much of the fact that there is a broad coalition of interest groups supporting the proposal. For the most part, these groups do not come forward with the purest of motives. Despite much of the rhetoric, they do not support the legislation because of some moral commitment to enhanced competition in insurance. In the main, their motives are much more parochial.

Let's examine the motives of some of these groups. The easiest supporters to dispense with are two groups with the same initials, the American Banker's Association and the American Bar Association. The Banker's have zero credibility on this issue since it affects them not at

all. They have even acknowledged that the only reason for their support of this type of legislation is to draw off insurance industry resources that would otherwise be used to oppose bank entry into insurance. Frankly we find it curious that with all the problems bankers have in their own backyard they would allocate any resources for the repeal of McCarran-Ferguson.

Thus far, insurers have resisted the temptation to speak in other Congressional fora to purely banking issues, such as deposit insurance premiums for foreign deposits and various consumer banking measures, but that policy of forbearance is under review.

The American Bar Association is an old and honorable institution, but it was apparently influenced on the McCarran issue by the trial lawyers within its ranks and by a basic misunderstanding of the insurance regulatory structure. As the Committee must be aware, the trial lawyers have long since declared war on McCarran-Ferguson in retribution for the insurance industry's efforts to enact meaningful tort reform legislation, legislation which would effectively limit trial lawyers' income from contingency fees and punitive damage awards. So we understand why the ABA has taken a position on this issue, but not why their comments should be accorded any credibility.

Similarly, a number of women's groups come to the McCarran debate not principally because of concerns over the status of insurance competition, but because of disagreements with the industry over the use of gender-based rate classifications.

Some consumer groups have also signed on to the anti-McCarran bandwagon, ostensibly to foster greater competition. But in general, they appear to be more interested in regulation than competition, and federal regulation at that.

Ralph Nader recently capsulized the mindset of many of the consumer groups when he argued that insurance was such a necessity that it should not be considered free enterprise. This is the anti-profit school which finds it distasteful for insurers to have any earnings left after paying claims. There is also an underlying message in Mr. Nader's statement that should give members of Congress pause. It is essentially that "price-fixing" is not inappropriate so long as it is done by the government with adequate input from consumer interest groups such as his own. No doubt it was this same mindset that fueled Mr. Nader's efforts to dictate the proper level for Congressional compensation.

It should also be noted that a principal consumer spokesman for McCarran repeal and Nader associate, Robert J. Hunter, has acknowledged being retained as a consulting actuary by at least two states to assist in developing state set rates for certain types of coverages. To complain about a lack of competition in insurance pricing while participating in the development of state-set rates is at best inconsistent. Clearly, much of the consumer group interest in McCarran reform is not based on a desire for more competition.

The groups that approach McCarran reform with the cleanest hands are the professional groups who have had problems obtaining liability insurance. They don't really care whether the problem results from competitive issues, business cycles or shortcomings in the tort system; they just want to get affordable insurance, and who can blame them? Unfortunately, they have been attracted by the sirens' song of the repeal McCarran cabal which has promised that reduced prices and increased availability will inevitably flow from elimination of the antitrust immunity. The opposite result is far more likely, but it is understandable that the professional groups would be susceptible to such claims.

So there are many and varied reasons for which these interest groups are supporting S.719, but enhanced competition is generally far down on the list. In the main, this and similar bills simply serve as rallying points for otherwise unfocused dissatisfaction with some practice or component of the insurance industry.

Action by ISO

It is too early to tell what will result from the action taken by the Insurance Services Office to eliminate the development of final advisory rates. Because the life and health insurance businesses do not use rating bureaus in developing rates, we are in a particularly poor position to speculate on the effects of this change. We are aware, however, that for the last several years the principal supporters of McCarran repeal have alleged that it is the development and distribution of final advisory rates by ISO that constitutes the so-called "price-fixing conspiracy" by property/casualty insurers. Without final advisory rates, they have said, industry members would be forced to develop their own final rates, thus producing more competition and lower prices.

If that is true, then it would seem that the action taken by ISO will solve the perceived problem. We believe that the ISO initiative, if fully implemented, would be an unprecedented step deserving an adequate test period in the marketplace. Not surprisingly, McCarran opponents have had to change their tune and are now saying that final advisory rates are not the real problem; or that the ISO initiative doesn't go far enough.

Frankly, we are not convinced that anything short of turning insurance into the equivalent of a public utility would satisfy the repeal McCarran lobby, and perhaps not even that.

The simple fact is, however, that the repeal McCarran lobby staked out a position on final rates and ISO has now called their bluff. Only time will tell if the absence of final advisory rates will have the predicted effect on the market.

Conclusion

The liability crisis was a product of complex causes. However, neither the regulatory system for insurance nor the industry's limited antitrust immunity bear any demonstrable relationship to the liability problem. While the liability insurance is a part of the insurance business it is a small part, and problems arising there should not suggest that the regulatory framework for the entire industry be abandoned or overlaid with an additional federal regulatory structure for antitrust and trade regulation.

Moreover, the benefits of general application of the antitrust statutes to the business of insurance are highly speculative and in any event outweighed by the confusion and uncertainty which would attend the loss of four decades of judicial precedent as to the legality of joint insurer activities. Further, the application of FTC trade regulation jurisdiction to insurance would address no apparent problem and would result in duplicate and/or conflicting regulation, all of which would be likely to increase taxes and the cost of insurance, create availability and affordability problems in other areas of insurance and slow down industry and regulatory responses to emerging problems.

If there are specific problems in the insurance which Congress believes need to be addressed, this can be done with specifically targeted legislation rather than the "throwing out the baby with the bath water" approach of repealing or modifying the McCarran Act. The voluntary action by ISO illustrates another promising avenue for resolving controversial issues and should be permitted a reasonable test period.

Finally, no consideration of a repeal or modification of McCarran is complete without asking the question: In light of the insurance industry's strong feelings about the need for McCarran, what will it do if McCarran is repealed? That can't be answered with certainty, although a few alternatives can be identified. First the industry can, in an effort to obtain certainty and reduce duplicative costs of regulation, seek a federal regulator and the preemption state regulation; or second, seek to bring as much of the activities and existing state regulation within the perimeters of the "state action" doctrine. In either case, neither the consumer nor the industry could expect concrete benefits to offset the potential problems of tampering with a system that is by all objective criteria working well.

NEW YORK STATE
SCHOOL BOARDS ASSOCIATION

The Dodge Building • 119 Washington Avenue, Albany, New York 12210 • (518) 465-3474 • FAX: (518) 465-3481

April 12, 1989

The Honorable Howard M. Metzenbaum
Chairman Senate Subcommittee on
Antitrust, Monopolies & Business
Rights
308 Senate Hart Office Building
Washington, DC 20510-6275

Dear Senator Metzenbaum:

The New York State School Boards Association would like to restate its support for your efforts to modify the McCarran-Ferguson Act to limit the federal antitrust exemption of the insurance industry. Last year, the Association was privileged to testify before the Senate Subcommittee on Antitrust, Monopolies, and Business Rights in support of **Senate Bill 1299.**

Last Tuesday I testified before the New York State Insurance Department on the issue of changing insurance market conditions for school districts. In this testimony the Association charges that the Department has failed to take any substantive action to investigate our allegations of insurance industry collusion. I have enclosed a copy of this testimony for your review.

As you may remember, I testified before your Subcommittee in June, 1988, that the Association was filing a complaint with the State Insurance Department alleging that the Association was precluded from entering the insurance business by the private insurance industry. I have enclosed a copy of the complaint for your information.

Our experiences, as discussed in the attached testimony, have led us to believe that collusion or other anti-competitive acts between insurance companies may have been the root problem leading to both the crisis and the inability of our insurance program to commence operations.

We are also skeptical of the some of the help given to us by the New York State Insurance Department. In many cases it led us to set rates for our districts far above those of our competitors. We are disappointed over the Department's response to our request for a full investigation of the reasons for the failure of our program and its denial of our Freedom of Information Law request for data upon which the response was based.

Until the Department has provided us with a fuller explanation and adequate substantiation of why we were unable to begin operation of our insurance program, we will remain suspicious of what occurred.

While we are awaiting such response from the Department, we are preparing a legislative program which, if enacted, will help consumers of insurance, such as school districts, protect themselves from insurance companies. I believe that Senate Bill 719 must be part of this legislative package.

Please do not hesitate to contact my office if I can be of any assistance.

Sincerely,

Louis Grumet
Executive Director

LG:WP:rd

Enclosure

cc: Governor Cuomo
Senator Biden
Senator D'Amato
Senator Kennedy
Senator Moynihan
Senator Simon

TESTIMONY

AT

PUBLIC HEARING ON CHANGING INSURANCE MARKET CONDITIONS

BY

LOUIS GRUMET

EXECUTIVE DIRECTOR

NEW YORK STATE SCHOOL BOARDS ASSOCIATION

NEW YORK STATE SCHOOL SERVICES FOUNDATION

ON

TUESDAY, MARCH 28, 1989

NEW YORK CITY

Good morning.

My name is Louis Grumet and I am the Executive Director of the New York State School Boards Association. The Association represents 98% of the elected school boards in the State of New York who, in turn, are responsible for the education of approximately 3 million children in the public schools of this State. The school boards of New York State spend approximately $18 billion annually.

In the mid 1980's, a significant amount of this annual expenditure was for liability and property insurance, the cost of which was skyrocketing and the availability of which was decreasing. While I will discuss this insurance crisis and the Association's response to it in more detail below, I would like to draw your attention to Governor Cuomo's statement when he signed the omnibus bill (Chapter 220 of the Laws of 1986) designed to alleviate the insurance crisis in New York State on June 28, 1986:

"To this day, we have not had a satisfactory explanation for the suddenness of this syndrome [rising insurance costs]. The truth is, the insurance industry overall is doing extremely well... You got all of these [insurance] people making a lot of money now in a position where they can make a lot more... I will confess to you, I remain a little suspicious."

Nearly three years later, despite the many dollars and man hours spent in trying to find solutions to the crisis and the many lessons learned about the insurance industry, we still have no satisfactory explanation for the insurance crisis of the mid-1980's. Was it caused by foolish underwriting decisions by the insurance industry? Was there really a need for tort reform?

Or, was the real reason for the crisis the collusive action of members of the insurance industries attempting to maintain their own profits and market shares?

One lesson we have learned is that the Insurance Department, which is supposed to protect the insurance consumers of New York State, is apparently part of the problem and not part of the solution.

I would like to express my profound disappointment over the Insurance Department's failure to police the school insurance market as well as it apparently polices other markets. In 1986 and '87, we tried to work cooperatively with the Department in fashioning an insurance program for school districts as one solution to the crisis. We hoped the result would be to lower insurance costs and increase competition in the school district insurance market place.

Now, looking back, we see that the Insurance Department made our goal difficult if not impossible to reach, by requiring us to set excessively high rates and insisting that rates were going up when we tried to enter the market place even though it was clear that our competitors were slashing premiums. We therefore believe that the failure of our program was due, in part, to your Department.

And we, like the Governor in 1986, remain suspicious of the actions of members of the insurance industry.

During the insurance crisis of the mid 1980's, school district catastrophe-umbrella insurance costs soared by up to four hundred (400%) percent, while coverage was cut in half. Premiums for underlying coverage also soared. New exclusions and higher deductibles also began to force school districts to cut back on educational programs.

As the insurance crisis heightened, a coalition of local governments, school districts and the City of New York was formed to deal with this problem. We went to the Legislature and the Governor and they enacted the 1986 Omnibus Liability Insurance Act which, inter alia, gave school districts the opportunity to establish a statewide municipal reciprocal insurance program, which is similar to insurance "pool", but is under tighter

regulation by the Superintendent of Insurance. We would be permitted to operate the reciprocal if we could enlist at least 25 school districts as subscribers.

Recognizing that we had a limited experience in the insurance industry, and at the suggestion of the Insurance Department, we decided to hire established, well-recognized and highly respected participants in the insurance industry to help us establish and operate the reciprocal.

The New York State School Services Foundation, a not-for-profit organization, was established by the School Boards Association to operate the reciprocal. We retained Marsh & McLennan, Inc., the world's largest insurance broker and marketer, to build our program. They put together a team which included General Reinsurance and American Reinsurance, two of the world's largest reinsurance companies, the Hartford Steam Boiler Inspection and Insurance Company for boiler and machinery coverage, The Travelers Insurance Company for claims administration, and Forrest T. Jones for errors and omissions coverage.

With this team of experts, and a $10 million loan from the Metropolitan Life Insurance Company arranged through the efforts of Superintendent Corcoran, we attempted to enter the insurance market in 1986. Many of the school districts in the State eagerly awaited our entry into the market. Approximately

400 of the 750 school districts and Boards of Cooperative Educational Services (BOCES) in the State contacted us to inquire about our product. Approximately 270 school districts asked for and received complete quotes. We worked on quotations for another approximately 60 districts.

We believed our reciprocal would be successful and that New York State would follow other states, like New Jersey and Texas, in establishing viable alternatives for insurance in the school district arena. We invested $464,000 in direct costs and expenses in our efforts and expected to save our member school districts millions of dollars in insurance premiums.

We seemed to be continually stymied in our efforts to begin the operations of the reciprocal. Despite the "blue chip" companies working with us, we were unable to get reinsurance treaties with General Reinsurance or American Reinsurance, even though our competitors were able to do so with other reinsurance companies. To do this day, we cannot understand how this is possible when the risks being insured are the same.

Having to get reinsurance on a facultative basis handicapped our efforts to get timely and reasonable quotes out to our members. While we realized we were the "new kids on the block" as a supplier of insurance, the delays and uncompetitive quotes (in some instances, four times as high as what the districts were then

paying) undermined our credibility with our members. While many districts may have been willing to take a chance on us, by the time we expected to commence operations, our reputation had been badly tarnished.

In addition, our internal review of the limited information available to us revealed a surprising development. The premium price quotations offered school districts by our competitors seemed to be lower for those districts that had requested premium quotations from the reciprocal. The pricing decreases were so dramatic for many school districts that we could not hope to offer a competitive price.

This price drop was unexpected and did not appear to be duplicated in the rest of the municipal market. For the prior three years, the cost of insurance had soared while the availability of insurance had declined. In fact, it took a special program (Municipal Market Assistance Program) of this Department to ensure that insurance was still available for all school districts.

As a result of this dramatic turnaround from the prior year in insurance costs, most school districts elected to stay with the existing insurance companies rather than join the reciprocal. We never met our minimum requirement of 25 participants and the reciprocal never began operating.

We were gratified that our efforts had saved the school districts, and therefore the taxpayers of this State millions of dollars. However, we were concerned that this price reprieve would be short-lived since the insurance industry works in a cyclical manner and that in the future, so much money would have to be paid for insurance that educational services would again be threatened. We feared that the insurance companies had engaged in anti-competitive acts to prevent the reciprocal from entering the market place. We were also worried that the failure of the reciprocal in 1986-87 would be used by the insurance companies as an excuse for inaction when the inevitable next "insurance crisis" developed.

We had not achieved the permanent change in the market place we had sought. The school districts of this State were (and are) still without the instrument necessary to provide adequate competition in the marketplace; one which would ensure that the insurance and risk management necessary to the operation of our schools remains in place.

As a result of our concerns, last spring we approached the Insurance Department and asked you, pursuant to the Insurance Law, to investigate whether unfair practicers by the competing private insurance companies had caused the demise of the reciprocal. We provided much information to this Insurance Department while, we were told, a preliminary market conduct investigation was performed.

On January 24 of this year, just two months ago, we were advised by this Department that no evidence of unfair or otherwise prohibited trade practices had been found after market conduct investigation of the school district insurance marketing efforts of two major carriers, CIGNA and UCIC (a copy of this response is annexed hereto as Exhibit "A"). Our disappointment in this response was deepened by the refusal of the Insurance Department to share with us any of the facts it had discovered following its market conduct investigation even though the Department seemed to indicate that a number of possible violations of its rules and regulations were found.

Then, on February 23, 1989, less than one month after telling us that no unfair insurance practices had been found in regard to the school insurance market, this Department announced that it would be stepping up its market conduct investigation and tightening regulation because "[b]ased upon unspecified market conduct findings, the Insurance Department had determined that insurers have once again unfairly sought to gain market share by cutting premiums" (see copy of announcement annexed hereto as Exhibit B).

We find it inconceivable that this Department can find clear evidence of unfair practices and, as a result, fine ten companies for violating regulations on pricing, while at the same time exonerating two major insurance companies offering insurance to school districts. We believe that a full review of your market

conduct investigation should be undertaken to determine why you have stated that only non-school insurance providers have engaged in unfair practices.

We also believe a full and complete examination of the entire school insurance market is needed to protect our schools, and the taxpayers, from unfair practices by the insurance industry. We say this because of the following actions, or inaction, of the Insurance Department:

1) In 1985, we asked the legislature to pass a bill requiring a separate rating classification for school districts and municipalities to see if the rates being charged were reasonable and necessary. Time and time again, we were told of school districts where premium rates soared even though no claims had ever been made. We believe that the liability crisis in regard to school insurance was manufactured by the insurance industry and that this would become readily apparent if school district claims were analyzed as a separate group apart from general liability claims.

The Jones Commission, which examined the matter at the direction of the Governor, concluded that our proposal for a separate rating classification deserved more study. The Insurance Department at the time successfully convinced the Legislature that a separate rating classification was not necessary. As a result

of the Insurance Department's opposition to our proposal, even today we do not know if school districts and other municipalities are being reasonably charged for the needed service of insurance. We note with interest that the Department is now proposing to require insurance companies to supply premium information separately for municipalities and school districts.

2) When we went to the Insurance Department for help in setting up the reciprocal, we were required to set rates significantly higher than the other companies began offering. As I mentioned above, in some cases the rates imposed upon us by this Department led to quotations four times greater than what the school districts were them paying. Also, the Insurance Department seemed convinced that premiums would increase by 60% from 1986-87 to 1987-1988 and worked with our actuaries to have our rates set accordingly. In fact, premiums for primary coverage decreased approximately 17% and catastrophe-umbrella premiums went down approximately 40% during the period in question.

Why did this Department require us to utilize higher rates when it knew or should have know of the dramatic decrease in premium prices being offered by our competitors?

3) Why doesn't the Insurance Department demonstrate that it has properly studied and analyzed what caused school districts who received price quotes from the reciprocal to receive approximately

14% more in premium reduction for umbrella coverage than those districts who did not receive a prince quote from the reciprocal? Isn't it strange that the amount of the premium price drops apparently depended on whether a school district had seriously considered doing business with us?

In regard to the issue of the availability of information concerning insurance premiums for school districts, I was asked by Chairman Howard Lasher of the Assembly Insurance Committee on December 4, 1985, where the data was to support our requests for tort reform and changes in the insurance industry. We also supplied data to the Jones Commission and the Insurance Department in 1986. When the Department did its investigation, we were also asked for data and willingly supplied it.

We believe it is high time to stop asking the victim to supply information which the Department and certainly the insurance industry already has.

Moreover, it seems to us that it is a duty of the Insurance Department, to collect relevant data and to present it to the public so that the public can be assured that the insurance industry is being properly regulated. We were not given access to the Department's data in regard to the investigation and we question whether information was sought from relevant members of the industry.

4) Was the insurance crisis in regard to school districts and municipalities a creation of the insurance companies? The Attorney General of this State and his counterparts in many other states believe that members of the insurance industry conspired to raise prices and reduce coverage. How can this Department be so quick to overlook our evidence of collusion in the school insurance market, particularly when it is the taxpayers of this State who are victimized by high school insurance premiums?

We note that the Attorney General has worked with attorneys general across the country on this issue, is part of the antitrust lawsuit underway in San Francisco and has testified before the Senate Judiciary Subcommittee on Antitrust, Monopolies & Business Rights in protection of the insurance purchasers of this State. He has also had this Association testify before the Subcommittee (See attached testimony annexed hereto as Exhibit "C".)

5) Why did the Superintendent of this Department encourage us to bring our complaints to him rather than the Attorney General, the legislature or the Governor, in order to investigate what happened? The Report of the Commission to Improve the Liability Insurance System, presented at the 1989 American Bar Association mid-year meeting (February 6-7, 1989) in response to the crisis concluded that only an investigator equipped with sufficient resources and subpoena power can truly determine whether there has been unfair collusion in the insurance industry.

Were we encouraged go bring our concerns to the Insurance Department so that his Department could control the investigation? If so, let me make it clear that we think the issue of school district insurance availability and cost is too significant an issue to disappear just because this Department says its private investigation finds nothing amiss. In the face of dwindling financial resources, and a budget deficit which may amount to billions of dollars, we cannot let an opportunity to protect our schools and the educational interests of our children disappear. Also, we cannot just write off the hundreds of thousands of dollars invested by our member school districts in lowering insurance costs without assurance that they will not fall victim to unnecessarily high insurance costs in the future without the protection of a reciprocal to ensure competition.

One of the other "partial" solutions to the crisis was to be a system of flex-rating, by which insurance rates were to be stabilized by keeping increases and decreases within certain levels.

We believe that flex-rating has been rather unhelpful, since the bands can be skirted by insurance companies quoting districts that they did not have before. These companies are, when first quoting a district, not subject to the bands. Simply trading off geographic areas is one way insurance companies can get around the bands.

In addition, when the reciprocal tried to get into business, some school districts saw their premiums decrease by as much as 23.9% on the underlying coverage and as much as 47% on the catastrophe-umbrella coverage. While we understand that reinsurance is not subject to the bands, such changes (supposedly permitted under your regulations through changes in the manner in which rates are computed) make a farce of the system.

In conclusion, the Insurance Department policy in regard to school district insurance problems has been one of study and delay. Now is the time for action. We therefore ask the Insurance Department to apply the same vigilance to the school insurance market that is used to find notorious violations and unfair practices in the casualty/property insurance general market.

Unless a full, complete and open investigation of what happened to our reciprocal insurance program is conducted, we, our member school districts and the taxpayers will never know whether we, the Governor and the Legislature misjudged the insurance industry in 1985-86 by believing that tort reform was part of the answer to the crisis.

Maybe the Governor's suspicions were correct and that there was collusion by the industry to set premiums at unreasonably high levels unsupported by any evidence of need and then to dramatically lower them to stave off competition which might have prevented collusion.

The Attorney General has courageously acted and shown great leadership in trying to get at the root of this problem. We encourage this Department to join him.

If you are unwilling to help the school districts of this State, we will ask the Governor and the Legislature to do it for you.

* * *

RECEIVED JAN 27 1989

EXHIBIT A

STATE OF NEW YORK
INSURANCE DEPARTMENT
160 WEST BROADWAY
NEW YORK 10013

JAMES P. CORCORAN
SUPERINTENDENT OF INSURANCE

RICHARD C. HSIA
DEPUTY SUPERINTENDENT

January 24, 1989

Louis R. Tomson, Esq.
Hiscock & Barclay
One Keycorp Plaza — Suite 1100
Albany, New York 12207-3411

Re: School Board Insurers Inquiry

Dear Lou:

This refers to ongoing discussions on this subject, including our December 22, 1988 telephone conversation and your January 9, 1989 letter. Triggered by analytical materials submitted to us that you believe indicate unlawful action preventing entry by School Board Insurers (SBI) into the school district insurance market in 1987, we have conducted market conduct investigations of the two major carriers (CIGNA and UCIC) in this market, in order to determine compliance with governing standards and to obtain support for your contentions.

In particular, our examiners scrutinized actual underwriting and other insurer files, searching for "reason to believe", with respect to unfair or otherwise untoward practices frustrating SBI efforts, warranting charges and a hearing pursuant to §2405(a) of the Insurance Law. While the Insurance Law does not permit release of market conduct documents, our basic methodology and conclusions can be described.

Our review concentrated on policy periods 1986, 1987 and 1988, to evaluate and compare insurer behavior before, during and after SBI efforts to enter this market, with the files reviewed covering not only school districts that sought SBI quotes but, in addition, those that did not, as derived from the district breakdowns you supplied.

Although we are pursuing a number of possible violations of governing rules and regulations, these intensive market conduct investigations have discovered no evidence of unfair or otherwise prohibited trade practices (whether or not concerted). We looked closely for illicit or collusive patterns of any kind, but found none. Patterns suggested by your statistical analysis are not confirmed when actual underwriting files are examined. Instead, it is evident from this examination that insurer behavior in terms of underwriting and pricing was essentially the same, regardless of whether school districts expressed any interest in SBI coverage.

This Department has made it plain to the insurance community that unfair competitive practices will not be tolerated. Yet, given multiple factors and forces, many reasons apart from such improper causes may explain why -- notwithstanding best efforts -- SBI did not materialize.

In sum, on the basis of our market conduct investigations, all involved here reach the conclusion that we have found no "reason to believe" that would justify continuing these investigations or commencing §2405 hearings at this time.

We nonetheless appreciate your concern and cooperation. Since collusive action cannot be definitively ruled out, we ask that any further information you may develop be brought to the Department's attention.

Very truly yours,

RICHARD C. HSIA
DEPUTY SUPERINTENDENT

cc: Louis Gruss
Superintendent Corcoran

REQUEST FOR INVESTIGATION AND HEARING PURSUANT TO INSURANCE LAW §§2404 AND 2405 AND STATEMENT OF CHARGES OF PROHIBITED TRADE PRACTICES

The New York State School Services Foundation (NYSSSF), by its attorneys Hiscock & Barclay, alleges that it has been the victim of unfair methods of competition and/or unfair and deceptive acts or practices prohibited by Article 24 of the Insurance Law, as follows:

1. From 1984 through 1986, school districts received substantial increases in premiums for insurance. The purpose of NYSSSF was to provide school districts with a reasonable cost alternative to the existing private insurance companies.

2. In 1986, School Board Insurers ("SBI") was established pursuant to New York State legislation (Article 61 of the Insurance Law) as a mutual reciprocal insurance company to make available appropriate insurance coverage for participating school districts. NYSSSF was established under the New York State Not-For-Profit Corporation law to be attorney in fact as required by Article 61 of the Insurance Law. The enabling legislation required NYSSSF to obtain at least 25 participating school districts in order to write insurance.

3. NYSSSF contacted and retained firms recognized as experts or leaders in the insurance industry to help assure success of the NYSSSF program.

4. For example, NYSSSF retained Marsh & McLennan to develop and administer its insurance program to school boards.

5. NYSSSF also retained Touche, Ross & Co. for actuarial services and relied upon Insurance Services Organization ("ISO") to generate the data upon which premiums pricing and risk evaluation would be based.

6. The NYSSSF program contemplated providing the primary layer of insurance coverage directly and reliance upon reinsurance companies including American Reinsurance and General Reinsurance in obtaining coverage and price quotations for umbrella insurance.

7. The response from the school districts of New York to the NYSSSF program was overwhelming with over 400 inquiries received for insurance proposals.

8. NYSSSF spent over $400,000.00 to pay for industry experts and to market its programs through advertising, appearances at school boards meetings, and other marketing efforts. Its staff was dedicated to making the programs work. In addition, the resources of the New York State School Board Association and others were utilized to assist NYSSSF personnel in entering the insurance business. Even so, NYSSSF was unable to obtain the legal minimum of 25 participants.

9. NYSSSF's failure to obtain 25 participants in its insurance program was due, in whole, or in part, to actions of the private insurance and reinsurance companies.

10. The first cause for failure was the inability of NYSSSF to obtain premium quotations and other requested information from the reinsurance companies. Despite constant efforts and pleas for response, the reinsurers failed to supply necessary

information so that NYSSSF was unable to make a proposal to approximately 75% of the inquiring school districts.

11. Further, during 1986 and 1987, NYSSSF was unable to obtain "treaty" reinsurance agreements, but instead was required to seek qualification for each potential insured separately. Upon information and belief, the reinsurers offered "treaty" coverage to NYSSSF competitors.

12. Also, during 1986 and 1987, school districts received unexpected and significant decreases in premium quotations from private companies competing with NYSSSF.

13. In many cases, NYSSSF was not able to obtain a competitive premium price from reinsurers to match premium quotes by the private insurance companies.

14. The basic coverage rates set by NYSSSF in reliance on ISO were higher than the rates of the competitive private insurance companies.

15. As a result of the foregoing, NYSSSF was unable to obtain sufficient participation in its insurance program and was forced to discontinue offering insurance.

16. NYSSSF therefore requests a hearing pursuant to §2405 of the Insurance Law to investigate whether ISO, American Reinsurance, General Reinsurance, CIGNA, and others, acted together to prevent NYSSSF from becoming a successful competitor in order to retain school district insurance business for themselves. Such actions constitute a violation of Insurance Law §2403. Accordingly, NYSSSF seeks a hearing into the circumstances surrounding its failure to obtain sufficient subscribers

to determine whether NYSSSF was the victim of concerted action by the existing insurance companies to prevent competition.

DATED: June 28, 1988

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AUTOMOTIVE SERVICE ASSOCIATION
1901 Airport Freeway, Suite 100, P.O. Box 929, Bedford, Texas 76095-0929, (817) 283-6205, Metro 267-1376, FAX (817) 685-0225

STATEMENT

OF DONALD A. RANDALL

ON BEHALF OF

AUTOMOTIVE SERVICE ASSOCIATION
321 D Street, NE
Washington, DC 20002
(202) 543-1440

on

The Repeal or Modification of McCarran-Ferguson--
The Need to Prohibit Joint Preparation of Insurance Contracts

Before the

U.S. SENATE

COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ANTITRUST,
MONOPOLIES, AND BUSINESS RIGHTS

April 18, 1989

Each year about 45 million motor vehicles are damaged. The American public spends approximately $27 billion dollars, or an average of $800 per vehicle to repair them. The Insurance Statistical Organization (ISO) reports that country-wide, the average paid claims-cost in 1985 was $1,217, which includes adjustment costs. The National Highway Traffic Safety Administration reports total economic costs for auto accidents at $74 billion (Attachment A). The auto insurers return only about 65 cents of every premium dollar paid. The balance of 35 cents goes for claims management, administration and profits (Attachment B). Claims adjustment costs alone amount to about 11 cents to maintain an army of wage, hour and procedure regulators. This contrasts dramatically with the 5 cents it costs to administer health insurance.

Under most state laws, the repair contract runs between the vehicle owner and the repair shop, yet the auto insurers insert themselves into the contractual arrangements between the vehicle owner and the repair shop, thereby controlling about 90% of these repairs. In recent years, the auto insurers have increasingly become the controlling and dominating force in specifying the prices to be charged by repair shops to their customers -- the vehicle owners. The insurers have also assumed the role of private regulators of the quality of these repairs, or the lack of it, by dictating the repair procedures and parts to be used.

In this 101st Congress, new bills have already been introduced in both the U.S. House of Representatives and the U.S. Senate that propose to repeal or amend McCarran-Ferguson. Senator Metzenbaum's bill, the Insurance Competition Improvement Act of 1989 (S. 719), specifies certain joint activities by insurers that would continue to be shielded from the antitrust laws. Section 3(c) of S. 719 includes a provision that would permit the insurers to jointly "prepar[e] and fil[e] policy forms ... for voluntary use by individual insurers...." This language would allow insurers to continue to conspire to set the terms and conditions contained in uniform contracts or "policies of insurance."

If the insurers are permitted to continue to agree on contract terms and conditions and thereby limit competition in insurance products, the consuming public will be harmed. It is precisely this conspiratorially agreed upon language that affords the insurers the ability to pay whatever they wish -- regardless of the stated deductible in the policy or contract. These uniformly uncertain contracts, subject to company interpretation, fail to clearly spell-out what the insured shall be entitled to receive in the event of a casualty loss. (SEE Attachment C)

These nearly uniformly vague, indefinite and confusing terms are contained in nearly all auto insurance contracts and enable the insurers to intimidate their insureds into adhering to their claims settlement policies and to thereby dominate and control the activities of the auto body repair shop owners. It is the McCarran-Ferguson Act which shields the insurance industry from antitrust prosecution for its collaboration on these uniform policies. If legislation is approved to amend the McCarran-Ferguson Act, it is crucial that the insurers are prohibited from jointly preparing insurance contracts.

The threat of a variable deductible or of cancellation or jacked-up premiums all contribute to the insurers' ability to manipulate the uninformed and unwary insureds. The capitulation of the insureds to this coercion gives the insurers the ability to covertly or overtly coerce repairers to adhere to the insurer-approved labor rate, the insurer-directed repair procedures and

the insurer demands that shops use cheaper off-shore, non-standard and frequently substandard parts or salvage parts.

Few insurers advise the insured about their limits on payments for original equipment parts. They do not openly compete in trying to sell their claims settlement virtues or quality of payments. They simply attempt to impose uniformly mediocre hourly labor rates that are nearly the same regardless of make, model or cost of the car or complexity of repair or owners demand for quality restoration. Their uniform "approved hourly labor rates" do not take into consideration the repair shops equipment or skills in restoring the damaged vehicles. They impose uniform mediocre commercial standard repairs.

There is no question that millions of damaged vehicles have received substandard repairs that did not make the insureds whole, did not cover the loss, and therefore, did not restore the vehicle to its pre-accident condition. In short, these repairs did not live up to the terms and promises in the contracts of insurance.

The purpose of the insurance industry's antitrust exemption under the McCarran-Ferguson Act was to make the system dependent upon state regulation and avoid federal intervention. Instead what has been perpetuated under this antitrust shield is a "system of private government." The insurance industry has developed private regulatory mechanisms in the administration of their claims settlement processes that impose anticompetitive conditions upon third party providers of goods and services. The insurers have already launched campaigns at the state level to impose additional state requirements that facilitate this private insurer control over third party providers. Pennsylvania, New Jersey, Massachusetts and others are enacting laws or considering bills that cede to the insurers the power to privately control major segments of other industries--not in the "business of insurance."

The insurers' efforts to be the private regulators of the wages and hours of the third-party providers of goods and services for their insureds is a great disservice to the American people. The ultimate costs for this private system of regulation is enormous. Individual insureds may save some on premiums but billions of dollars annually are lost due to depreciation in value of the vehicles which are not being fully restored. The federal laws favoring competition in all industries, including insurance, must not continue to permit the insurers to substitute unregulated private control or regulation of other segments of industry. Private regulations can be as anticompetitive and injurious as federal or state regulation, especially where they administer multibillion dollar purchases on behalf of their insureds. Moreover, there must be federal oversight of insurers' activities, even where there is effective state regulation,

because the insurers have significant conflicts of interests with their insureds due to their profit incentives.

It is long past time for the federal and state governments to step into this outrageous claims process. The insurers must be made subject to the federal antitrust laws and to ongoing federal oversight of their daily claims settlement practices. In addition, effective state regulation must be instituted. To do anything less will leave in place a system that is corrupted and corrupting. The rising tide of consumer dissatisfaction with the auto insurers will continue to grow until equity and competition come into play and all collision repair shops can compete to sell quality repairs -- not simply standard, commercial, mediocre insurance-company-approved repairs.

If the insurers would divert some of the billions of dollars, now spent on trying to dominate and direct the collision industry through regulation of wages, hours, and procedures, to assuring quality repairs, the cost of insurance would not need to rise and yet vehicles could still be fully restored. If insurers would shift emphasis to quality repairs, rather than private regulation of the collision shops, the public would benefit. The insurers might even find that the public complaints about insurers would diminish. Their cost for administering auto insurance could be reduced!

Auto insurers can limit their liability just as health insurers limit their liability by specifying the percentage of the claim costs they will pay, up to a stated limit. Some may offer more, some less. A variety of coverages can promote competition. One insurer might offer a deluxe, full coverage to make the insured whole -- not 80% whole but 100% whole. Another might offer quality restoration for luxury cars but commercial standard repairs for older or inexpensive cars. Clearly stated minimum standards of liability coverage can be specified by the National Association of Insurance Commissioners or the States, just as that group now specifies uniform reports, etc.

Whatever Congress does, it must assure that the nation's insurers cease being the private regulators of the various third party suppliers to their insureds. Both government and private wage, hour and rate regulations are bad for our economy, for the insureds and for the insurers themselves. Private insurer regulations of a $400 billion segment of our economy must cease. The insurers are not subject to Federal oversight. The F.T.C. is barred from studying or investigating their activities. The F.T.C.'s authority should be restored and the Commission should be directed to investigate the insurance industry to determine whether predatory practices have been used by the large insurers to drive the small insurers out of business.

The imposition of competitive disciplines upon the nation's insurers, under effective state regulations, will benefit all the American people including the body repair shops. Competitive quality repairs could once again become a source of pride for the automotive collision repair industry.

Under the McCarran Act, state regulation without active federal oversight will continue to perpetuate an insurer "system of private government." The insurance industry--a $400 billion dollar industry--is not regulated, judged or disciplined by the normal rules of competition. The result is that a major part of our national economy is essentially self-monitored.

Under the McCarran-Ferguson Act, the antitrust exemption permitting standard or uniform insurance contracts or "policies" affords casualty insurers an inordinate ability to dominate, control and abuse the claims settlement process. It is part of the reason millions of Americans are unhappy with the insurance industry.

McCarran-Ferguson must be repealed and no exemption should be granted for the joint writing of insurance contracts.

APPENDIX A

VEHICLE INSPECTIONS COST SAVINGS EVALUATION DATA FOR COMBINING PMVI AND I&M

To evaluate the cost of this program, it seems appropriate to consider the following:

174 million registered motor vehicles
1.9 trillion miles traveled 1986
95% of all passengers are moved by motor vehicles
90% of all freight is moved by trucks
$237 billion spent on passenger costs for private vehicles
$ 34 billion all air, trains, buses; all for-hire passenger costs

Source: American Trucking Association
National Automobile Dealers Association
U.S. Bureau of Labor Statistics

NHTSA COSTS OF MOTOR VEHICLE CRASHES FOR 1986			POTENTIAL 9.2% * SAVINGS USING OLD INSPECTION TECHNOLOGY EQUIPMENT	
Deaths	46	thousand	4,232	lives saved
Injuries	3.4	million	312,800	injuries prevented
Damaged vehicles	45	million	4,140,000	saved from collision damage
(Economic Costs)			(Savings)	
Vehicle property losses due to accidents	$ 27.37	billion	2.52	billion
Vehicle insurance expenses	$ 20.86	billion	1.92	billion
Vehicle accident productivity losses	$ 16.38	billion	1.51	billion
Vehicle accident legal and court costs	$ 4.32	billion	0.40	billion
Vehicle accident medical costs	$ 4.12	billion	0.39	billion
Vehicle accident emergency costs	$ 0.70	billion	0.06	billion
Vehicle accident other costs	$ 0.45	billion	0.04	billion
			6.84	billion Total Economic Savings

* NHTSA 1977,"EFFECTS OF AUTO INSPECTIONS ON ACCIDENT RATES"

U.S. Department of Transportation

News

Office of the Assistant Secretary for Public Affairs
Washington, D.C. 20590

FOR RELEASE MONDAY
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NHTSA 47-87
Contact: Ron De Fore
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NHTSA STUDY DETAILS HIGH COST TO PUBLIC OF MOTOR VEHICLE CRASHES

Motor vehicle crashes cost Americans more than $74 billion in 1986, the National Highway Traffic Safety Administration (NHTSA) reported today. The crashes caused more than 46,000 deaths, 3.4 million injuries, and 45 million damaged vehicles during the year. Even those motorists not involved in collisions during the year paid an estimated $97 each in related insurance costs.

"These staggering dollar figures represent only a portion of the total cost of motor vehicle crashes," said NHTSA Administrator Diane K. Steed. "It is impossible to place a monetary value on the pain, suffering and loss of life.

"Nearly $60 billion of the economic loss could be saved if crashes, injuries and deaths were reduced. If we can continue to increase safety belt use, enforce posted speed limits, and crack down on drunk driving, we can go a long way toward ending this drain on our financial resources, as well as preventing human tragedies," Steed said.

NHTSA's estimate of the total economic cost of motor vehicle crashes for 1986 by cost category is as follows:

Cost Category	Dollars in Billions	Percent of Total
Property losses	$27.37	36.9
Insurance expense	20.86	28.1
Productivity losses	16.38	22.1
Legal and court costs	4.32	5.8
Medical costs	4.12	5.6
Emergency costs	0.70	0.9
Other	0.45	0.6
Total	$74.20	100.0

Steed explained that more than 90 percent of the traffic crashes last year involved no personal injury. They accounted for most of the $27 billion in property damage, which represents the largest portion of the total bill. For those crashes causing injury and death, the losses were $16.4 billion in economic productivity, $4.1 billion in medical expense and $3.8 billion in attorney's fees and other court costs.

The NHTSA Administrator also noted that recent improvements in highway safety have helped to keep the dollar losses from going even higher.

"The fatality rate in this nation is at an all-time low, and we are, perhaps, more safety-conscious than at any other time in our history. These estimates show us both the size of the problem that still faces us, and the possible economic rewards of making further improvements in traffic safety," she said.

Additional information may be obtained by requesting a copy of the report, "The Economic Cost to Society of Motor Vehicle Accidents, 1986 Addendum," from the Technical Reference Division, NHTSA NAD-52, U.S. Department of Transportation, Washington, DC 20590.

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U.S. Department of Transportation

National Highway Traffic Safety Administration

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Chart I

Percentage of Auto Insurance Premium Dollar Allocated to Expenses

5 Year Moving Average	
76 - 80	34.2
77 - 81	34.2
78 - 82	34.5
79 - 83	34.9
80 - 84	34.7
81 - 85	35.3
82 - 86	35.3

SOURCE: NICO, p. 3

ATTACHMENT B

The language of insurance contracts

Government Employees Insurance Company (GEICO)

"We will pay for collision loss to the owned or non-owned auto for the amount of each loss less the applicable deductible."

Nationwide

"Under this coverage, we will pay for direct and accidental loss of, or damage to, your auto and its equipment caused by collision or upset. For each occurrence, we will pay for the loss or damage minus your declared deductible amount."

State Farm

"We will pay for loss to your car caused by collision but only for the amount of each such loss in excess of the deductible amount. If the collision is with another motor vehicle insured with us, you do not pay your deductible if it is $100 or less as we pay it."

Allstate

"Allstate's limit of liability is the actual cash value of the property or damaged part of the property at the time of loss. The actual cash value will be reduced by the deductible for each coverage as shown on the declaration page. However, our liability will not exceed what it would cost to repair or replace the property or part with other of like kind and quality."

NOTE: Though the language in the above provisions appears on its face to be fairly specific, notice that "loss" is not defined in any of them. This vague language is used so that the issuing insurance company can apply its "company policy" in interpreting the claims settlement procedures, conditions, and terms. What is loss. These contracts leave to the insurer this determination.

As a result of the vague and indefinite language, the deductibles stated in the policy become variable--not fixed. For example, if the policy holder insists that his damaged vehicle be fully restored to its pre-crash value at the repair shop of his choice and this shop charges an hourly labor rate higher than the insurer's approved hourly rate, the policyholder may be charged the difference. Additionally, his "fixed" deductible may also be increased by the difference between his shop's bill and the theoretical price the insurer can obtain "similar," non-standard, salvage or off-shore, Asian-made parts--compared to original equipment (OE) car company parts.

ATTACHMENT C